HB

278

Representative Mike Hawker
Alaska State Legislature

Session
State Capitol
Juneau, AK 99801
907 465-4949 direct
800 478-4950 toll free
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Interim
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Member
House Finance Committee
Legislative Budget & Audit Committee

House District 32
Eagle River
Anchorage
Rainbow
Indian
Bird
Girdwood
Portage
Whittier
Sunrise
Hope

House Bill 278
Sponsor Statement

"An Act relating to the Alaska Municipal Bond Bank Authority; permitting the Alaska Municipal Bond Bank Authority or a subsidiary of the authority to assist state and municipal governmental employers by issuing bonds and other commercial paper to enable the governmental employers to prepay all or a portion of the governmental employers' shares of the unfunded accrued actuarial liabilities of retirement systems and authorizing governmental employers to contract with and to issue bonds, notes, or commercial paper to the authority or its subsidiary corporation for that purpose; and providing for an effective date."

HB 278 authorizes the Alaska Municipal Bond Authority to consider issuing pension obligation bonds (POBs) at the request of the state or a municipal governmental employer. POBs are a proven and acceptable tool to manage pre-existing liabilities for state and local pensions. Bond market participants are receptive to POBs, including bond insurers, rating agencies and investors.

HB 278 expands the authority of the Alaska Municipal Bond Authority to support the state or a municipality that wishes to include POBs in their strategy to reduce the cost of meeting unfunded pension liabilities.

This bill does not authorize any debt instruments to be issued. The state or a municipality would need to take a separate specific action to utilize this new ability of the Municipal Bond Bank Authority.

Staff Contact: Juli Lucky 465-6587 Pat

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Fact Sheet for House Bill 278

Short Title: HB 278 Retirement System Bonds

Current Version: HB 278

Staff Contact: Juli Lucky or Paulyn Swanson 465-4949

Summary:

- Authorizes the Alaska Municipal Bond Bank Authority to issue pension obligation bonds that assist state and municipal governmental employers to finance the payment of all or a portion of their actuarial pension liability.

Benefits:

- Properly planned and executed, pension obligation bonds (POBs) can lower the cost of funding the past service cost component of public pension liabilities.
- If the state wide unfunded past service liability were bonded, savings of approximately $1.5 billion in present value dollars could be realized.
- This bill is needed to empower public entities with the ability to determine if POBs are an appropriate component of their fiscal strategy.

Background:

The combined total unfunded liability of the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) is approaching $6 billion. This liability includes unfunded pension and post-employment healthcare benefits.

POBs are a financing mechanism to minimize the cost funding pension obligations by borrowing at a lower rate of interest than the bond proceeds earn after being deposited in the pension fund. POBs must be carefully structured and may not be appropriate for all employers, however they should be an option for those public entities who wish to consider them.

Revised 5/2/2005

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To: Representative Paul Seaton, Chair
House State Affairs Committee

From: Representative Mike Hawker

Date: January 25, 2005

Re: House Bill 278 – proposed amendment

The House State Affairs Committee requested that my office prepare an amendment to House Bill 278 to allow smaller communities to join together to take advantage of pension obligation bonds. Upon discussion with Legislative Legal Counsel, we learned that AS 29.35.010(13) authorizes municipalities to enter into cooperative agreements.

> Sec. 29.35.010. General powers.
>
> All municipalities have the following general powers, subject to other provisions of law:
>
> (13) to enter into an agreement, including an agreement for cooperative or joint administration of any function or power with a municipality, the state, or the United States;

Therefore, it is their belief that we do not need additional permissive language in this statute to allow municipalities to enter into cooperative agreements for pension obligation bonds.

Merrill Lynch Response to Question from
House State Affairs Committee Hearing on January 17, 2006

Overview

During the House State Affairs Committee hearing on Tuesday, January 17, 2006, a question was raised regarding the impact of pension obligation bonds on the 5% employer contribution rate growth cap that is currently in place for annual PERS contribution rates. As described in more detail below, Merrill Lynch believes that pension obligation bonds can be structured such that the effect of the current 5% cap on the growth in employer contribution rates for PERS remains in place. In fact, pension bond issuers have quite a bit of latitude in how they structure debt service repayment features, as we highlight in two Oregon examples below.

Detailed Description

In the pension obligation bond numbers that Merrill Lynch included and presented in the Thursday, January 12, 2006 House State Affairs Committee hearing, potential PERS savings were calculated by taking the difference between two cases:

- **No Action Case:** Total expected employer payments including the 5% growth cap assuming no pension obligation bonds were issued.
- **Pension Bond Case:** Total expected employer payments assuming pension obligation bonds were issued and the debt service from these bonds replace the expected past service rate payments that employers would have to pay if no bonds were issued.

In structuring the "Pension Bond Case", Merrill Lynch amortized the debt service such that the difference between the total expected employer contribution rates in the two cases listed above were approximately level over time. Therefore, because the "No Action Case" included the 5% growth cap in its total expected employer contribution rates and the "Pension Bond Case" was structured around the "No Action Case", both cases result in limited and gradual growth in expected employer contribution rates over the first few years.

In order to create this type of flexible and beneficial structure, issuers would have to defer bond debt service slightly such that payments would grow over time. This is not unusual for pension bond financings; in fact, we have included on the following page the debt service structures from two pension financings in Oregon which had growing debt service structures yet received solid A and AA category ratings from Moody's and Standard and Poor's (two of the largest and most respected bond rating agencies). That said, we would caution against deferring debt service too aggressively, and would recommend that pension bond issuers limit debt service growth to the expected employer payments growth that would have likely occurred had pension bonds not been issued.

Conclusion

Merrill Lynch believes that the debt service from pension obligation bonds can be structured such that the effect of the current 5% cap on the growth in employer PERS contribution rates remains in place. Issuers have latitude in how they structure pension bond debt service payments, and rating agencies have accepted growing debt service structures provided the growth is similar to expected employer payments had no pension bonds been issued. We would be happy to answer any questions regarding this memo or regarding the numbers that we provided to the House State Affairs Committee Hearing on Thursday, January 12, 2006.

Examples of Pension Bond Financings with Deferred Debt Service Schedules

Period Ending	Oregon School Boards Association Series 2003 Rating: A1 / AA-	State of Oregon Series 2003 Rating: Aa3 / AA-
6/30/2004	$35,756,937	$69,609,411
6/30/2005	34,187,709	118,764,872
6/30/2006	47,702,709	118,764,872
6/30/2007	49,772,709	120,819,872
6/30/2008	53,287,709	125,951,811
6/30/2009	55,537,709	131,305,329
6/30/2010	59,362,709	136,884,719
6/30/2011	61,792,709	142,704,344
6/30/2012	66,212,709	148,769,082
6/30/2013	69,352,709	155,090,876
6/30/2014	73,382,709	161,681,978
6/30/2015	76,792,709	168,555,022
6/30/2016	81,147,709	175,719,621
6/30/2017	84,857,709	183,188,600
6/30/2018	89,632,709	190,970,172
6/30/2019	93,677,709	199,086,967
6/30/2020	98,897,709	207,548,485
6/30/2021	103,292,709	216,370,191
6/30/2022	108,967,709	225,567,942
6/30/2023	113,722,709	235,152,696
6/30/2024	119,907,709	245,145,513
6/30/2025	125,052,932	255,567,300
6/30/2026	131,434,504	266,429,051
6/30/2027	136,684,252	277,749,421
6/30/2028	65,532,168	
Total:	$2,035,949,973	$4,277,398,147

IOUSE COMMITTEE REPO

(7)
Date Referred to Committee: April 19, 2005 **FURTHER REFERRALS:** Finance

Date of Committee Action: 1/26/06

The **STATE AFFAIRS** Committee considered: **HB 278**

HOUSE BILL NO. 278 **RETIREMENT SYSTEM BONDS**

"An Act relating to the Alaska Municipal Bond Bank Authority; permitting the Alaska Municipal Bond Bank Authority or a subsidiary of the authority to assist state and municipal governmental employers by issuing bonds and other commercial paper to enable the governmental employers to prepay all or a portion of the governmental employers' share of the unfunded accrued actuarial liabilities of retirement systems and authorizing governmental employers to contract with and to issue bonds, notes, or commercial paper to the authority or its subsidiary corporation for that purpose; and providing for an effective date."

Recommends it be replaced with [ ] HCS *or* [ ] CS *for* ________________(________)
For Senate Bills with new title: [ ] Technical Title [ ] New Title: HCR________ **[ ] Same Title [ ] New Title**

[ ] attach amendments
[ ] add new referral to ___________Committee
[ ] Letter of Intent__________Committee

List of Abbrev for Depts.:
ADM
CED
COR
CRT
EED
DEC
DFG
GOV
HSS
LEG
LAW
LWF
MVA
DNR
DPS
REV
DOT
UA

***NEW* FISCAL NOTES** *Assigned by Chief Clerk's Office

List by Dept(s):	*FN#	Fiscal	Indet.	Zero
REV		X		

***PREVIOUS* FISCAL NOTES**

List by Dept(s):	FN#	Fiscal	Indet.	Zero

Signing with recommendations	Printed Last Name	DP	DNP	NR	AM
Berta Gardner	Gardner	X			
[signature]	LYNN			X	
[signature]	ELKINS			✓	
[signature]	RAMRAS			X	
[signature]	Gruenberg	–			
[signature] Gatto	Gatto			X	
Chair: Paul Seaton	SEATON			X	
Chair:					

ALASKA MUNICIPAL LEAGUE

RESOLUTION #2006-02

A RESOLUTION URGING THE STATE TO PROVIDE FOR A STATUTORY MAXIMUM EMPLOYER CONTRIBUTION RATE AND ALLOW EMPLOYERS THE OPTION OF REFINANCING THEIR PERS/TRS DEBT

WHEREAS, the State of Alaska created the Public Employees Retirement System (PERS) in 1962 to provide a retirement system for state and participating municipal employees; and

WHEREAS, many cities and boroughs have participated in PERS for many years; and

WHEREAS, the basic premise of a defined benefit pension plan is that employer and/or employee contributions are invested by the plan administrator in accord with sound actuarial principles so that adequate funds are available for retiree pensions and health care benefits; and

WHEREAS, the PERS system is seriously underfunded on a statewide basis; the plan's assets are roughly equal to only 70% of the projected plan expenses; and

WHEREAS, in response to the underfunding, PERS administrators have indicated that the employer PERS contribution rate will increase by 5% compounded annually every year for many years; and

WHEREAS, this past March, the Senate Finance Committee of the Alaska Legislature found the following reasons for PERS underfunding:

- Inaccurate assumptions
- Historical understatement of system liabilities
- Rising health costs
- 3-year "bear" market downturn
- Declining interest rates
- Unfavorable demographic changes
- Timing of the recognition of market losses
- Artificially low contribution rates in good times
- Legislation that has increased benefits
- Awarding of Post Pension Retirement Adjustments

WHEREAS, by passage of Senate Bill 141, the State has taken a significant step towards a long-term resolution of the statewide PERS shortfall; effective July 1, 2006, the existing defined benefit plan will become a defined contribution plan for employees hired on or after that

date; under a defined contribution plan the liability of the employer is limited to making contributions; and

WHEREAS, all municipalities and local taxpayers face eventual fiscal calamity as the employer rate increases by 5% of total salaries paid per year; and

WHEREAS, establishing a maximum employer PERS rate will enable municipalities to afford to continue to provide essential public services; and

WHEREAS, the State government has vastly superior revenue resources compared to municipal governments; and

WHEREAS, statutory changes to allow municipalities and the state to refinance the existing debt could potentially save several percentage points of interest charges each year.

NOW, THEREFORE BE IT RESOLVED that the Alaska Municipal League agrees to the following:

- To avoid penalizing local taxpayers and students, the PERS statutes should be amended to provide for a maximum employer contribution rate of 20%, with any amount above 20% to be paid by the State, as part of the changes to resolve the plan underfunding.
- That the State allow employers the option of refinancing their existing PERS/TRS debt in order to use financing methods that are available at a rate lower than 8.25%.

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: HB 278
() Publish Date:

Revision Date/Time (Note if correction):
Dept. Affected: Revenue
Title: Alaska Municipal Bond Bank Borrowing Authority
RDU
Component: Alaska Municipal Bond Bank
Sponsor
Requester
Component No. 121

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services						
Travel	25.0					
Contractual	7,040.0	40.0	40.0	40.0	40.0	40.0
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	**7,065.0**	**40.0**	**40.0**	**40.0**	**40.0**	**40.0**
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
Bond Proceeds	7,000.0					
Bond Bank Investment Earnings	65.0	40.0	40.0	40.0	40.0	40.0
TOTAL	**7,065.0**	**40.0**	**40.0**	**40.0**	**40.0**	**40.0**

Estimate of any current year (FY2006) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

The bill expands the ability of the Alaska Municipal Bond Bank Authority (Bond Bank) to borrow money for loans to communities to include prepaying unfunded accrued actuarial liabilities of the retirement system. The premis of undertaking this type of transaction is providing communities with an efficient means of borrowing to fund their unfunded liability (assumed to be growing at 8.25%). The difference between the cost of capital and 8.25% is assumed to provide financial relief to the community.

The fiscal note contemplates a transaction of considerable size, up to a billion dollars, occur in FY 2007. If there was a delay, seven million of the dollars of the cost would shift to the year a transaction did occur. It is possible that there would be additional transactions in subsequent years with similar costs.

Contractual costs include rating agency fees, financial advisor, bond counsel, printing, cusip service, underwriting, & other miscellaneous costs.

Prepared by: Deven Mitchell
Phone 465-3750
Division: Alaska Municipal Bond Bank Authority
Date/Time 1/5/06 12:00 AM
Deven Mitchell
Date
Agency: Alaska Municipal Bond Bank Authority

(Revised 9/7/2005 OMB)

Municipal Taxable Pension Financings
2001-Present

Sale Date	Issuer	Issue Description	Series	State	Par ($mm)
12/21/05	Pomona City-California	Pension Obligation Ref Bonds	Series 2006 AR	CA	36.205
12/20/05	Clark-Pleasant Comm Sch Corp	GO Pension Bonds	Series of 2005	IN	4.000
12/15/05	Evansville-Vanderburgh Schl Bldg Corp	GO Pension Bonds	Series of 2005	IN	18.000
12/08/05	Bell Public Financing Authority	Pension Revenue Bonds	Series 2005	CA	9.225
11/22/05	Beaver Co-Pennsylvania	Taxable GO Pension Bonds	Series of 2005	PA	13.675
11/16/05	Brockton City-Massachusetts	General Obligation Bonds		MA	101.515
11/16/05	Solano Co-California	Pension Funding Bonds	Series 2005	CA	42.385
11/09/05	Duquesne City-Pennsylvania	General Obligation Pension Bonds	Series B of 2005	PA	5.845
11/08/05	Paducah City-Kentucky	GO Pension Tax Bonds	Series 2005	KY	3.160
11/01/05	Richmond City-California	Taxable Pension Funding Bonds	Series 2005	CA	114.995
10/27/05	Syracuse City-New York	Pension Obligation Bonds	Series 2005 D	NY	3.862
10/18/05	Dracut Town-Massachusetts	Pension Obligation Bonds		MA	2.175
10/01/05	Moraga-Orinda Fire Dt	Taxable Pension Obligation Bonds	Series 2005	CA	28.435
10/01/05	San Bernardino City-California	Taxable Pension Obligation Bonds		CA	50.401
09/14/05	Oregon Local Governments	Limited Tax Pension Obligations	Series 2005	OR	186.945
08/18/05	Inglewood City-California	Taxable Pension Oblig Bonds	2005 Series C	CA	6.135
08/18/05	Inglewood City-California	Pension Obligation Bonds	2005 Series A&B	CA	58.851
08/18/05	Miami Beach-Florida	Special Obligation Ref Bonds	Series 2005	FL	53.030
08/17/05	Oceanside City-California	Pension Obligation Bonds	Series 2005	CA	42.780
08/03/05	Erie Co (Tonawanda) SD	School Dt Pension Sys BANs	Series 2005	NY	1.210
08/02/05	New Castle City-Pennsylvania	General Obligation Bonds	Series of 2005	PA	7.990
07/21/05	Contra Costa Fire Protect Dt	Pension Obligation Bonds	Series 2005	CA	129.900
06/21/05	Riverside City-California	Pension Obligations Bonds	2005 Series A	CA	30.000
06/15/05	California Statewide Comm Dev Au	Pension Obligation Bonds	2005 Series A	CA	20.635
06/14/05	Huntington Park City-California	Pension Obligation Ref Bonds	2005 Series A	CA	23.050
06/14/05	Oregon School Boards Association	Limited Tax Pension Bonds	Series 2005 B	OR	10.080
06/10/05	Oregon Community College Dt	Ltd Tax Pension Obligations	Series 2005	OR	57.835
06/08/05	Oregon Community College Dt	Limited Tax Pension Oblig	Series 2005A	OR	458.440
06/01/05	Detroit City-Michigan	Certificates of Participation	Series 2005B	MI	800.000
05/25/05	Detroit City-Michigan	Certificates of Participation	Series 2005A	MI	640.000
04/14/05	Atlantic (Pleasantville) SD BOE	School Refunding Bonds	Series 2005	NJ	2.810
04/13/05	Fairfield City-California	Pension Obligation Ref Bonds	Series 2005 A2	CA	11.830
04/11/05	Guttenberg Town-New Jersey	Pension Refunding Bonds		NJ	0.755
03/24/05	Denver City and Co SD #1	Certificates of Participation	Series 2005 A	CO	86.045
03/08/05	Houston City-Texas	GO Pension Bonds	Series 2005	TX	57.165
03/08/05	Monmouth Co (Howell Twp) BOE	School Refunding Bonds	Series 2005	NJ	19.080
03/01/05	South Gate City-California	Pension Obligation Ref Bonds	Series 2005	CA	24.400
02/24/05	Lockport-New York	Pension System Bonds	2005 Series B	NY	1.055
02/10/05	Riverside Co-California	Pension Obligation Bonds	Series 2005A	CA	400.000
01/20/05	Fairfield City-California	Pension Obligation Ref Bonds	Series 2004A	CA	8.920
01/20/05	Fairfield City-California	Pension Obligation Ref Bonds	Series 2004B	CA	20.995
01/19/05	Dallas City-Texas	GO Pension Bonds	Series 2005 A,B,C	TX	393.348
12/17/04	Pike Co School Corp	GO Pension Bonds	Series 2004	IN	6.200
12/10/04	Southeast Dubois Co Sch Bldg Corp	GO Pension Bonds	Series of 2004	IN	4.590
12/09/04	Long Beach-New York	Pension System Bonds	2004 Series B	NY	0.695
12/07/04	Olean Town-New York	Pension Bonds	Series 2004	NY	0.571
12/07/04	Onondaga Co-New York	General Obligation Pension Bonds	Series 2004	NY	6.000
12/02/04	Dekalb Co (Dekalb) CUSD	GO Pension Bonds	Series of 2004	IN	6.150
12/02/04	Lake Central School Corp	GO Pension Bonds	Series 2004	IN	17.200
12/01/04	Bucks Co-Pennsylvania	General Obligation Bonds	Series of 2004	PA	85.230
12/01/04	Northeast Dubois Co Sch Bldg Corp	General Obligation Pension Bonds	Series of 2004	IN	4.405
11/30/04	Hamburg-New York	Pension Serial Bond		NY	0.164
11/23/04	Hanover Comm School Corp	GO Pension Bonds	Series 2004	IN	1.295
11/22/04	Hobart School City-Indiana	GO Pension Bonds	Series 2004	IN	2.680
11/19/04	Indiana Bond Bank	School Severence Funding Bonds	Series 8B	IN	70.540
11/18/04	North Adams School Corp	GO Pension Bonds	Series 2004	IN	6.965
11/17/04	Minneapolis City-Minnesota	GO Pension Bonds	Series 2004	MN	4.740
11/17/04	Minneapolis City-Minnesota	Pension Bonds	Series 2004	MN	24.970
11/10/04	Griffith Public Schools	GO Pension Bonds	Series of 2004	IN	5.050
10/28/04	Niagara Falls-New York	Pension System Serial Bonds	2004 Series B	NY	0.635
10/27/04	San Diego Metro Transit Dev Bd	Taxable Pension Obligation Bonds	2004 Series B	CA	38.800

Municipal Taxable Pension Financings
2001-Present

Sale Date	Issuer	Issue Description	Series	State	Par ($mm)
10/21/04	Lackawanna-New York	Pension System Bonds	Series 2004	NY	0.680
10/21/04	San Diego Metro Transit Dev Bd	Taxable Pension Obligation Bonds	2004 Series A	CA	38.690
10/13/04	Sacramento Metro Fire Dt	Pension Funding Bonds	Series 2004 B&C	CA	32.069
10/13/04	Sacramento Metro Fire Dt	Pension Funding Bonds	Series 2004A	CA	37.930
10/13/04	Syracuse City-New York	Pension Obligation Bonds	Series 2004 G	NY	8.472
09/23/04	Fremont Community Schools	GO Pension Bonds	Series 2004	IN	3.600
09/15/04	Crown Point Comm School Corp	GO Pension Bonds	Series 2004	IN	12.000
09/14/04	Kankakee Valley School Corp	GO Pension Bonds	Series 2004	IN	6.500
08/31/04	South Knox School Bldg Corp	GO Pension Bonds	Series 2004	IN	1.760
08/24/04	New Albany-Floyd Consl Sch Corp	GO Pension Bonds	Series 2004	KS	14.000
08/23/04	Lake Ridge Schools Renov Corp	GO Pension Bonds	Series of 2004	IN	1.010
08/05/04	Erie Co (Tonawanda) SD	SD Pension System BANs	Series 2004	NY	1.210
07/27/04	Carroll Co-Maryland	Taxable Pension Funding Bonds	Series 2004	MD	12.800
07/13/04	Depew Village-New York	Pension Serial Bonds		NY	0.308
07/01/04	North Tonawanda City SD	SD Pension System Serial Bonds	Series 2004	NY	2.460
06/29/04	Pomona City-California	Pension Obligation Ref Bonds	Series AJ & AK	CA	38.000
06/28/04	San Diego Co-California	Pension Obligation Bonds	Series 2004 B1-B2	CA	147.825
06/24/04	Sacramento Co-California	Taxable Pension Funding Bonds	Series 2004 C-1,2,3	CA	426.131
06/23/04	San Bernardino Co-California	Pension Obligation Bonds	Series 2004 B-2	CA	30.000
06/23/04	San Bernardino Co-California	Pension Obligation Bonds	Series 2004 B-3	CA	30.000
06/23/04	San Bernardino Co-California	Pension Obligation Bonds	Series 2004 B-1, F	CA	89.825
06/23/04	San Bernardino Co-California	Pension Obligation Bonds	Series 2004 C	CA	125.000
06/22/04	Clinton Prairie Sch Bldg Corp	GO Pension Bonds	Series 2004	IN	3.950
06/22/04	San Diego Co-California	Pension Obligation Bonds	Series 2004A & C	CA	306.288
06/17/04	South Coast Air Quality Mgmt Dt	Pension Obligation Bonds	Series 2004	CA	47.030
06/17/04	Union City-California	Pension Obligation Bonds	Series 2004	CA	22.998
06/14/04	California Statewide Comm Dev Au	Pension Obligation Bonds	2004 Series A1 & A2	CA	197.084
06/10/04	Solano Co-California	Pension Funding Bonds	Series 2004A & B	CA	96.665
06/09/04	San Bernardino Co-California	Pension Obligation Bonds	Series 2004A	CA	189.070
06/04/04	Illinois Finance Authority	Revenue Bonds	Series 2004D	IL	3.545
05/18/04	Syracuse City-New York	Pension Obligation Bonds	Series 2004C	NY	2.039
05/17/04	MSD of Steuben Co	Taxable GO Pension Bonds	Series 2004	IN	7.100
05/12/04	Dunmore Boro-Pennsylvania	GO Pension Funding Bonds	Series of 2004	PA	4.115
05/12/04	Oregon Local Governments	Pension Obligation Bonds	Seires 2004	OR	126.260
05/05/04	Sayreville Borough-New Jersey	GO Pension Refunding Bonds	Series 2004	NJ	0.520
04/27/04	Manville Borough-New Jersey	Pension Refunding Bonds	Series 2004	NJ	0.915
04/06/04	Newark City Housing Auth	Spec Oblig Pension Ref Bonds	Series 2004	NJ	6.840
03/22/04	Fresno Co-California	Taxable Pension Obligation Bonds	2004 Series B	CA	75.000
03/17/04	Allentown-Pennsylvania	GO Refunding Bonds	Series of 2004	PA	58.800
03/10/04	Fresno Co-California	Taxable Pension Obligation Bonds	2004 Series A	CA	327.898
02/26/04	Kansas Development Fin Auth	Revenue Bonds	Series 2004C	KS	500.000
02/18/04	Middlesex Co-New Jersey	Pension Refunding Bonds	Series 2004	NJ	10.315
02/12/04	Pennington-New Jersey	General Obligation Bonds	Series 2004B	NJ	0.320
02/11/04	Oregon Community College Dt	Ltd Tax Pension Obligation Bonds	Series 2004	OR	96.710
02/06/04	Oregon School Boards Association	LTd Tax Pension Obligations	Series 2004	OR	467.820
01/22/04	Long Beach-New York	Pension Sys Bonds	Series 2004	NY	0.695
12/30/03	Orleans Comm School Corp	GO Pension Bonds	Series 2003	IN	3.815
12/18/03	Milwaukee City Redev Auth	Pension Funding Bonds	2003 Series C & D	WI	15.719
12/18/03	Milwaukee City Redev Auth	Pension Funding Bonds	2003 Series C & D	WI	130.850
12/16/03	Calumet Co-Wisconsin	Taxable GO Promissory Notes		WI	1.400
12/12/03	Westchester Co-New York	Pension Bond Anticipation Notes	Series 2003B	NY	11.690
12/10/03	Wisconsin	Gen Fund Appropriation Bonds	Series 2003 B	WI	281.500
12/10/03	Wisconsin	Gen Fund Appropriation Bonds	Series 2003 A	WI	330.000
12/10/03	Wisconsin	Gen Fund Appropriation Bonds	Series 2003 B	WI	333.350
12/10/03	Wisconsin	Gen Fund Appropriation Bonds	Series 2003 A	WI	850.000
12/09/03	Shelbyville Central Schools	GO Pension Bonds	Series 2003	IN	6.500
12/04/03	Indiana Bond Bank	School Severance Funding Bonds	Series 5-A	IN	184.730
12/04/03	Rockville Comm School Bldg Corp	GO Pension Bonds	Series 2003	IN	0.650
12/04/03	Suffolk Co-New York	Pension Obligation Bonds	Series 2003	NY	22.955
10/30/03	Orlando Utilities Commission	Wtr & Electric Rev Pension Bonds	Series 2003T	FL	55.325
10/29/03	Metuchen-New Jersey	Pension Refunding Bonds	Series 2003	NJ	0.870

Municipal Taxable Pension Financings
2001-Present

Sale Date	Issuer	Issue Description	Series	State	Par ($mm)
10/28/03	Oregon	GO Pension Bonds	Series 2003	OR	2083.960
10/10/03	Naugatuck Boro-Connecticut	GO Pension Bonds	Issue of 2003	CT	49.265
10/02/03	Franklin Borough-New Jersey	Pension Refunding Bonds		NJ	0.330
09/16/03	Danville Comm School Corp	GO Pension Bonds	Series 2003	IN	3.185
09/11/03	Lakewood Twp-New Jersey	Pension Obligation Ref Bonds	Series 2003	NJ	1.145
09/04/03	Clifton-New Jersey	Refunding Bonds	Series 2003	NJ	1.300
08/27/03	Kansas Development Fin Auth	Revenue Bonds	Series 2003 H	KS	40.250
08/21/03	Rochester-New York	GO Pension Bonds	Series 2003 I	NY	12.800
08/05/03	New Brunswick City-New Jersey	Pension Refunding Bonds	Series 2003	NJ	9.496
07/15/03	Sacramento Co-California	Pension Ref Cap Appreciatn Bonds	Series 2003 A & B	CA	152.321
07/14/03	Hamilton Twp (Mercer)-New Jersey	Pension Obligation Ref Bonds	Series 2003	NJ	5.595
07/09/03	Santa Rosa City-California	Pension Obligation Ref Bonds	Series 2003A	CA	20.500
07/09/03	Santa Rosa City-California	Pension Obligation Ref Bonds	Series 2003B	CA	30.170
06/26/03	San Luis Obispo Co-California	Pension Obligation Bonds	Series 2003	CA	137.194
06/25/03	Minneapolis City-Minnesota	General Obligation Pension Bonds	Series 2003	MN	36.000
06/17/03	Essex Co-New Jersey	GO Pension Refunding Bonds	Series 2003	NJ	54.665
06/16/03	Willingboro Twp-New Jersey	Refunding Bonds	Series 2003	NJ	0.525
06/12/03	Portland Community College Dt	Ltd Tax Pension Bonds	Series 2003	OR	119.995
06/05/03	Illinois	General Obligation Bonds	Series of 6/03	IL	10000.000
06/04/03	South Brunswick Twp-New Jersey	Pension Refunding Bonds		NJ	2.050
06/04/03	South Plainfield-New Jersey	GO Pension Ref Bonds	Series 2003	NJ	0.325
05/29/03	Warsaw Community Schools	GO Pension Bonds	Series 2003	IN	5.870
05/22/03	Monmouth Co-New Jersey	Pension Refunding Bonds	Series 2003B	NJ	17.210
05/15/03	Kern Co-California	Taxable Pension Oblig Ref Bonds	Series 2003B	CA	50.000
05/15/03	Kern Co-California	Taxable Pension Oblig Ref Bonds	Series 2003A	CA	238.177
05/13/03	Sonoma Co-California	Taxable Pension Obligation Bonds	Series 2003 A&B	CA	231.200
05/07/03	Marin Co-California	Taxable Pension Oblig Bonds	Series 2003	CA	112.805
04/29/03	Sussex Co-New Jersey	Pension Ref Bonds		NJ	3.900
04/28/03	North Brunswick Twp-New Jersey	Refunding Bonds	Series 2003	NJ	2.075
04/23/03	Contra Costa Co-California	Taxable Pension Obligation Bonds	Series 2003A	CA	322.710
04/10/03	Oregon Community College Dt	Ltd Tax Pension Obligations	Series 2003A&B	OR	153.582
04/09/03	East Orange City-New Jersey	GO Refunding Bonds	Series 2003	NJ	9.351
04/07/03	Englewood City-New Jersey	Pension Refunding Bonds	Series 2003	NJ	3.420
04/04/03	Oregon School Boards Association	Ltd Tax Pension Oblig Bonds	Series 2003	OR	927.080
04/03/03	Newark City-New Jersey	GO Refunding Bonds	Series 2003	NJ	40.747
03/31/03	Paterson-New Jersey	GO Refunding Bonds	Series 2003	NJ	13.045
03/27/03	Hamilton Twp (Mercer)-New Jersey	BANs	Pension Series 2003	NJ	5.535
03/24/03	Carteret Board of Education	Pension Refunding Bonds	Series 2003	NJ	2.450
03/24/03	Lyndhurst Board of Education	School Pension Refunding Bonds	Series 2003	NJ	2.030
03/24/03	Woodbridge Twp-New Jersey	Pension Refunding Bonds	Series 2003	NJ	4.785
03/17/03	Lodi-New Jersey	Pension Refunding Bonds	Series 2003	NJ	1.270
03/14/03	Gainesville City-Florida	Pension Obligation Rev Bonds	Series 2003A&B	FL	89.890
03/13/03	High Point Regional High SD	Refunding Bonds	Series 2003	NJ	1.945
03/13/03	Trenton City-New Jersey	GO Refunding Bonds	Series 2003A&B	NJ	42.936
03/10/03	Lakewood Twp SD	Refunding School Bonds	Series 2003	NJ	2.350
03/10/03	Lyndhurst Twp-New Jersey	Pension Refunding Bonds	Series 2003	NJ	1.765
03/10/03	Red Bank Regional High SD	Refunding School Bonds	Series 2003	NJ	1.600
03/10/03	Verona Township Board of Ed	Refunding School Bonds	Series 2003	NJ	1.540
03/07/03	New Jersey Economic Dev Auth	State Pension Funding Ref Bonds	Series 2003	NJ	375.000
03/03/03	Fort Lee Borough-New Jersey	Pension Refunding Bonds	Series 2003	NJ	4.230
02/28/03	Lawrence Twp SD	School Refunding Bonds	Series 2003	NJ	3.270
02/26/03	Lodi Board of Education	School Pension Ref Bonds	Series 2003	NJ	3.275
02/25/03	Passaic Co-New Jersey	Pension Refunding Bonds	Series 2003	NJ	6.560
02/19/03	Monmouth Co (Howell Twp) BOE	School Refunding Bonds	Series 2003	NJ	3.630
02/18/03	Bergenfield-New Jersey	Pension Refunding Bonds		NJ	1.310
02/13/03	Monroe Twp-New Jersey	Pension Refunding Bonds	Series 2003	NJ	1.145
02/12/03	Weehawken Twp-New Jersey	Pension Refunding Bonds	Series 2003	NJ	4.750
02/06/03	Bayonne City-New Jersey	GO Refunding Bonds	Series 2003	NJ	15.795
02/04/03	Brick Twp-New Jersey	Pension Refunding Bonds	Series 2003	NJ	4.650
02/03/03	Passaic-New Jersey	GO Pension Refunding Bonds	Series 2003	NJ	7.800
01/28/03	Jersey City-New Jersey	General Obligation Bonds	Series 2003	NJ	23.595

Municipal Taxable Pension Financings
2001-Present

Sale Date	Issuer	Issue Description	Series	State	Par ($mm)
01/27/03	Manchester Twp-New Jersey	Pension Refunding Bonds	Sereis 2003	NJ	1.795
01/24/03	Jackson Twp Board of Education	Taxable Refunding School Bonds	Series 2003	NJ	6.550
12/19/02	Garrett-Keyser-Butler Comm SD	GO Pension Bonds	Series 2002	IN	1.540
12/19/02	South Bend Comm School Corp	Taxable School Corp Pension BANs		IN	1.300
12/18/02	Spotswood Borough BOE	School Refunding Bonds	Series 2002	NJ	0.770
12/16/02	Matawan-Aberdeen Regional SD	School Refunding Bonds	Pension Series 2002	NJ	5.665
12/12/02	Mendocino Co-California	Taxable Pension Oblig Bonds	Series 2002	CA	91.945
12/11/02	Minneapolis City-Minnesota	GO Pension Bonds	Series 2002	MN	10.600
12/11/02	Minneapolis City-Minnesota	GO Pension Bonds	Series 2002	MN	25.000
12/03/02	Bartholomew Consol School Corp	GO Pension Bonds	Series 2002	IN	12.500
12/03/02	Wall Twp BOE	Refunding School Bonds	Series 2002	NJ	5.840
10/30/02	North Miami-Florida	Var Rte Dem Spec Oblig Ref Bonds	Series 2002	FL	14.735
10/25/02	Atlantic City Board of Education	Refunding School Bonds	Pension Series 2002	NJ	9.255
10/10/02	Oregon School Boards Association	Limited Tax Pension Obligations	Series 2002A&B	OR	774.663
09/19/02	Northeastern School Corp	GO Pension Bonds	Series 2002	IN	1.225
09/17/02	San Diego Co-California	Taxable Pension Obligation Bonds	Series 2002C	CA	100.000
09/17/02	San Diego Co-California	Taxable Pension Obligation Bonds	Series 2002A	CA	132.215
09/17/02	San Diego Co-California	Taxable Pension Obligation Bonds	Series 2002B	CA	505.125
09/10/02	West Haven City-Connecticut	General Obligation Pension Bonds		CT	67.305
09/06/02	Imperial Co-California	Taxable Pension Bonds	2002 Series A	CA	33.265
08/16/02	Frankton-Lapel Sch Bldg Corp	Taxable GO Pension Bonds	Series of 2002	IN	1.855
08/09/02	Long Beach City-California	Taxable Pension Oblig Ref Bonds	Series 2002 A	CA	43.950
08/09/02	Long Beach City-California	Taxable Pension Oblig Ref Bonds	Series 2002 A	CA	44.000
07/11/02	South Madison Comm School Corp	Taxable GO Pension Bonds	Series of 2002	IN	2.560
06/26/02	Woonsocket-Rhode Island	GO Pension Bonds		RI	90.000
05/10/02	Indiana Bond Bank	School Severance Fund Bonds	Series 1	IN	57.260
04/30/02	Franklin Comm School Corporation	Taxable GO Pension Bonds	Series 2002	IN	1.145
03/26/02	Tippecanoe School Corporation	GO Pension Bonds	Series 2002	IN	1.350
03/20/02	Marion Co-Oregon	Ltd Tax Pension Bonds	Series 2002A&B	OR	26.819
03/15/02	Oregon Local Governments	Ltd Tax Pension Oblig Bonds	Series 2002A&B	OR	228.615
03/13/02	Fresno Co-California	Pension Obligation Ref Bonds	Series 2002	CA	117.055
02/27/02	Corvallis-Oregon	Ltd Tax GO Bonds	2002 Series A	OR	23.913
01/23/02	Fresno-California	Taxable Pension Oblig Bonds	Series of 2002	CA	205.335
12/19/01	Monroe Co Comm School Bldg Corp	Retirement/Severance Bonds	Series 2001	IN	1.800
12/12/01	Lewiston City-Maine	GO Pension Bonds		ME	16.395
11/20/01	Rumford-Maine	GO Pension Bonds		ME	1.035
10/31/01	Manchester City-New Hampshire	Pension Obligation Bonds	Series 2001C	NH	20.810
10/17/01	Hockville Centre Vllg-New York	Pension System	Series 2001	NY	1.800
10/03/01	Oakland City-California	Taxable Pension Obligation Bonds	Series 2001	CA	195.639
07/18/01	Portland City-Maine	Multi-Modal Txbl GO Pension Bonds		ME	111.000
06/13/01	South Gate City-California	Taxable Certs of Participation	Series 2001	CA	8.500
06/05/01	Imperial Irrigation Dt	Taxable Pension Oblig Rev Bonds	Series 2001	CA	75.000
03/08/01	Contra Costa Co-California	Taxable Pension Obligations	Series 2001	CA	107.005
					$ 28,814.031

Pension Obligation Bonds

January 12, 2006

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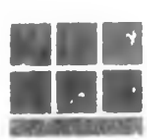

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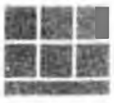
What is a Pension Obligation Bond?

- A pension obligation bond is a financing used to defray unfunded pension costs.
- Pension systems measure assets on hand against the present value of projected liabilities over the long term.
- If liabilities exceed assets, the difference is known as the "Unfunded Accrued Actuarial Liability" or "UAAL."
- With lagging investment returns, increases in healthcare costs, and actuarial revaluations, many public and private pension systems have found themselves significantly under-funded.



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What is a Pension Obligation Bond?

- Repayment of the UAAL is amortized over a fixed period and built into payroll rates at a given interest rate, 8.25 percent in Alaska.
- Retirement system thereby becomes the "banker" for the shortfall, as employers repay the loan over the amortization period.
- Many jurisdictions have used Pension Obligation Bonds to refinance these "loans" at rates lower than the amortization rate.

Why Might Pension Obligation Bonds be Useful in Alaska

- According to the recently released 2004 valuation, assuming above-average growth in population:
  - PERS rates rise to **32% of payroll** beginning in 2011, and do not decline until 2029.
  - TRS rates rise to **50% of payroll** in 2011 and continue increasing to 56% by 2028 before declining.
- Properly structured pension obligation bonds can be an effective tool for immediately reducing payroll rates and producing long term savings for jurisdictions.
- In Oregon, jurisdictions are projected to save over $1.3 billion from use of this technique.

Alaska Pension System *

	Alaska	
	PERS	TRS
Asset base	$ 8.2 billion	$ 3.9 billion
Covered Employees	69,135	21,220
Average employer rate	16.77% (1)	21.00% (2)
Funded ratio	72.00%	64.00%
UAAL as of 2004 valuation	$ 3.4 billion	$2.3 billion

*As of June 30, 2004.

(1) Effective for Fiscal Year 2006, Actuarially computed at 25.63%.

(2) Effective for Fiscal Year 2006, Actuarially computed at 38.85%.

The Arbitrage Issue

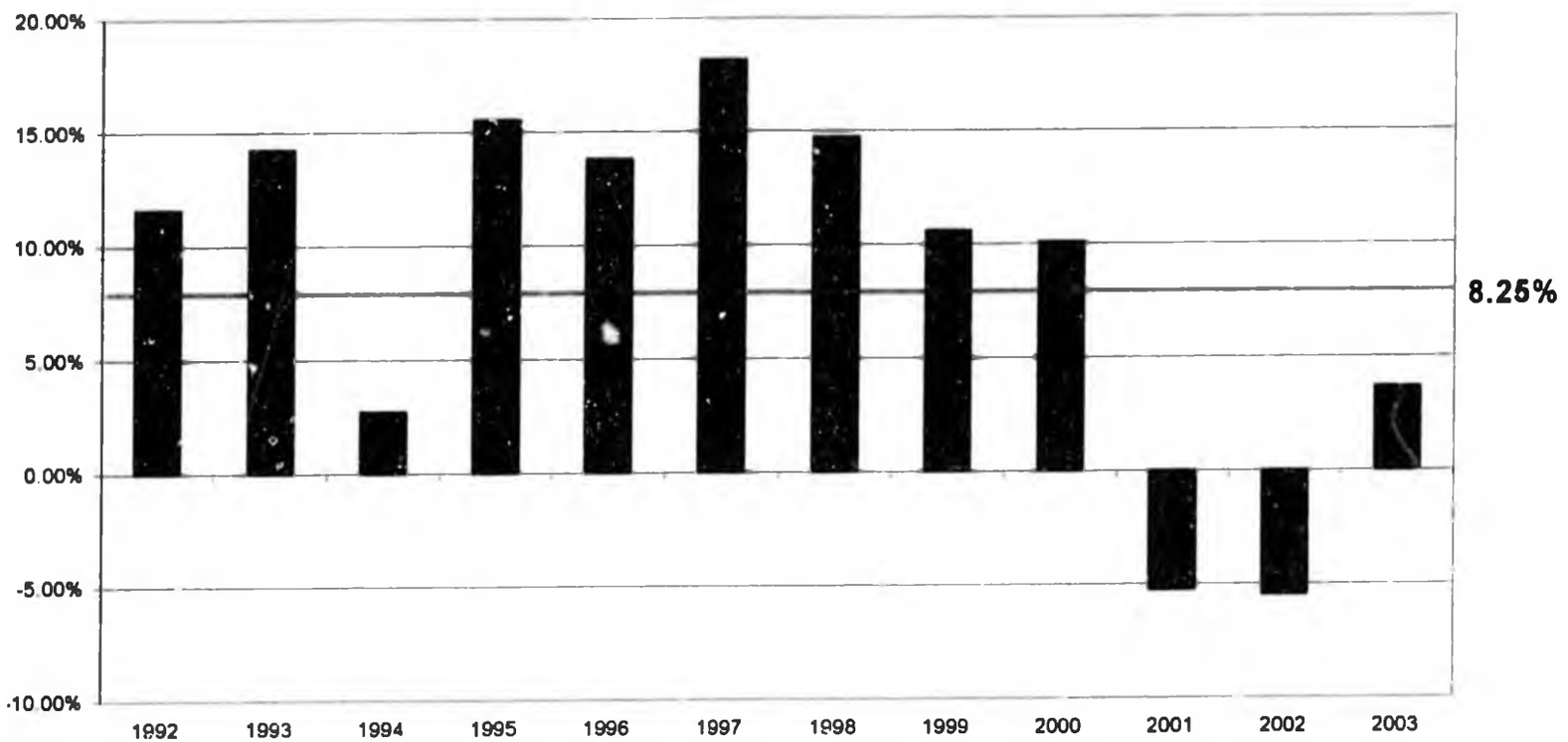
Issuing a pension bond is not like refinancing your mortgage…

- Success from borrowing depends on the market returning more than the cost of the bond.
  - For Alaska borrowers, if investment returns equal 8.25% over 25 year period over the life of the bonds, costs will be reduced as estimated.
  - If investment returns are greater than 8.25%, cost reductions will be greater than projected.
  - If investment returns are less than 8.25% cost reductions will be positive, but less than projected.
  - If investment returns are less than the interest rate on the bonds, borrowers will be worse off than if they had done nothing.

Alaska PERS

Alaska Public Retirement System

History of Investment Results



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Bonding a Popular Tool

Many jurisdictions throughout the country have chosen to finance PERS liabilities with bonds.

Oregon example:

- A total of 133 school districts, cities, counties and the State have issued $5.4 billion of pension bonds in Oregon.
- Savings projected at $1.3 billion overall, assuming an 8.00% rate of return.
- Original statutory authority provided to local governments and school districts in 2001 for issuance of "full faith and credit obligations."
- School Districts also granted authority to enter into intercept agreement with the State, whereby operating funds were additionally pledged. This approach resulted in "State" credit rating.
- State Constitutional amendment approved by voters in 2003 authorizing the State to issue GO bonds for its share of the liability. Voter approval margin was 55.25%.

Oregon Process

- Bond proceeds are placed in a "lump sum account" for benefit of employer. Earnings and losses directly accrue to that account.
- Lump sum account is used to provide prepayment credit on payroll rates charged to jurisdictions.
- Although bonds have to be sold on taxable basis, interest rates for most borrowings have been well under 6%.
- Oregon State Treasury regression analysis conducted in July 2003 projected probability of positive arbitrage in PERS refinancing at nearly 90%.

Recent Returns – Oregon Lump Sum Accounts

Issuer	Par	TIC	Total Return	Annualized
Series 2002 A&B - Local Governments	$ 238 m	7.00%	43.04%	11.74% (1)
Series 2002 - School Districts	$ 775 m	5.60%	59.01%	19.14%
Series 2003 - Schools, Community Colleges	$ 1,080 m	5.73%	51.88%	20.08%
Series 2004 - Schools, Community Colleges	$ 400 m	5.49%	23.51%	13.44%
Series 2004- Local Governments	$ 126 m	6.11%	24.28%	16.19%

(1) As of November 30, 2005

Lessons Learned

1. Payment to PERS does NOT guarantee UAAL will be paid off in full.

2. Changes in size of UAAL

   - Judicial, legislative, regulatory or investment activities can cause future changes to UAAL. Further increases would continue to be responsibility of jurisdiction.
     - Reductions: Lump sum payment would put jurisdiction in surplus. Funds will not be returned to jurisdiction, but surplus is used to reduce payroll rates further.
     - Increases: Lump sum payment would defray total deficit. UAAL would not be as high as would otherwise be the case.

   In any case, arbitrage risks remain the same for existing lump sum payment.

3. Structure of the financing matters

   - Inappropriate to use unrealistic assumptions about rates of return.
   - Amortization structure of bonds should match amortization of UAAL that PERS system uses.
   - Not prudent to have back weighted structured where all savings are produced in early years.

Lessons Learned

4. The "housekeeping issues" are often the most critical
   - Adequate protection and proper accounting of lump deposits are critical.
   - Statutes and regulations needed to ensure that the employers making the deposit are the ones getting the credit, and that credit is for appropriate amount.
5. Bond Related Considerations
   - Bonds are not likely to be subject to early redemption.
   - Rating agencies will scrutinize structure carefully to ensure payment of liability is not further deferred.
   - Changes "soft" liability to "hard" liability, which may put some limitations on financial flexibility.
6. Variations in payroll growth are not immediately reflected in debt structure
   - Under current structure, if payroll declines, payments to PERS decline.
   - Using bonds, if payroll declines, payments on the bonds do not change.

Alaska Legislative Considerations

Goal: Give all jurisdictions, at their discretion, meaningful access to capital markets for the purpose of financing pension liabilities.

1. Access
   - Express authorization for all types of jurisdictions to issue obligations for this purpose either individually or through another entity.
   - Authorization for individual jurisdictions to pool together through another entity (either state entity such as Bond Bank and/or pool created with a Trustee).
2. "Meaningful" Access
   - Without additional credit support, some jurisdictions may not be able to enter market on a subject-to-appropriation basis at a competitive rate.

- Forms of additional credit support
  - Intercept of State funding - particularly useful for school districts
  - Bond reserves
  - Bond insurance
  - Voter approval of constitutional amendment allowing use of general obligation bonds

HB 278 – Comments

- One part of a broad solution.
- The nature of the obligation between local entities and the Bond Bank will need to be defined.
- Would like the bill expanded to cover broader intercept authority, particularly for schools. (Pension obligation financing provides an opportunity to increase funds available for education.)
- Would like to see additional flexibility for jurisdictions to group together through pools organized by trustee.
- Entire solution will require legislative, administrative and, potentially, constitutional changes.

Pension Bonds in Alaska: Potential Savings

Types of Obligations

- Savings would be maximized if general obligation (GO) bonds could be issued. This would not be possible without an amendment to the State Constitution
- Appropriation-backed obligations still provide substantial savings for highly rated entities.
- Taxable.
- Non-callable.
- Opportunity to issue obligations dependent on current debt market conditions – as interest rates rise, pension obligation financing becomes less attractive.

Example: City & Borough of Juneau

Assumptions

- Investment rate of return = 8.25%
- Annual payroll growth rate = 5.50% (*)
- Past service amortization:
  - Fixed 25 years, effective June 30, 2002. (**)

*City and Borough of Juneau – Notes to audited financial statements

**State of Alaska PERS Actuarial Valuation Report as of June 30, 2002 (Page 5)

Summary of Results

- Assumes payoff of 100% 6/30/04 PERS UAAL for the City and Borough of Juneau, brought forward to March 1, 2006.

Dated Date	3/1/2006
Delivery Date	3/1/2006
Obligations Par Amount	$ 75,075,000
True Interest Cost	6.06%
Aggregate Savings	$ 23,758,921
Average Annual Savings	$ 1,079,951
Net PV Savings	$ 14,881,383
Percentage Savings of Refunding Obligations	19. 82%

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file w/ paul bill packet
HB 278

Pension Obligation Bonds
System wide Analysis

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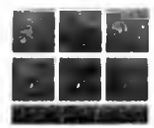

SEATTLE-NORTHWEST
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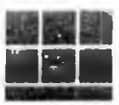
Pension Obligation Bonds
Alaska PERS system wide refinancing analysis

- A refinancing of the $3.4 billion PERS UAAL could result in net present value savings of over $1 billion
  - This translates into a system wide rate reduction of approximately 15.50%
  - Results in a net PERS rate savings of approximately 3.07%

	FY07	FY08	FY09	FY10
Total PERS Rate	21.77%	21.77%	21.77%	21.77%
Less: Projected Rate Credit	(15.50%)	(15.50%)	(15.50%)	(15.50%)
Plus: Debt Cost	12.36%	12.43%	12.43%	12.43%
Net PERS Rate	18.63%	18.70%	18.70%	18.70%
Net Savings in PERS Rate	3.14%	3.07%	3.07%	3.07%
Net Cashflow Savings	$51,161,811	$51,944,574	$53,987,342	$56,147,686



SEATTLE-NORTHWEST SECURITIES CORPORATION

Assumptions

- UAAL brought forward from 6/30/04 to 7/1/06 UAAL lump sum payment date
- 5.75% true interest cost (TIC, borrowing rate)
- 25-year fixed amortization
- 4% salary growth rate
- 8.25% UAL borrowing cost
- Level percentage of payroll savings structure
- Assumes elimination of 5% rate cap

Sensitivity Analysis

Municipality of Anchorage
Annual Savings from Pension Bond assuming 6.00% TIC

	12% Earnings	8.25% Earnings	4% Earnings
FY 2006	1,010,489	1,010,489	1,010,489
FY 2007	1,253,934	1,253,934	1,253,934
FY 2008	3,485,268	2,411,768	1,210,862
FY 2009	5,643,081	3,633,284	1,469,585
FY 2010	7,367,117	4,286,983	1,095,336
FY 2011	8,817,906	4,518,049	229,458
FY 2012	10,453,550	4,767,566	(691,042)
FY 2013	12,289,353	5,031,950	(1,674,081)
FY 2014	14,342,643	5,307,542	(2,727,933)
FY 2015	16,645,143	5,602,709	(3,849,155)
FY 2016	19,213,120	5,907,672	(5,052,801)
FY 2017	22,085,008	6,231,726	(6,335,242)
FY 2018	25,294,943	6,576,264	(7,701,209)
FY 2019	28,877,504	6,938,849	(9,159,824)
FY 2020	32,873,972	7,318,513	(10,719,433)
FY 2021	37,338,780	7,720,777	(12,382,825)
FY 2022	42,331,475	8,147,261	(14,158,035)
FY 2023	47,921,048	8,595,699	(16,059,136)
FY 2024	54,202,457	9,067,403	(18,100,552)
FY 2025	61,317,948	9,565,593	(20,303,418)
FY 2026	69,529,677	10,090,417	(22,716,807)
FY 2027	79,683,185	10,649,279	(25,504,160)
Total Savings	**601,977,602**	**134,633,727**	**(170,865,990)**
Present Value Savings	**258,474,528**	**71,393,516**	**(56,730,895)**

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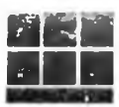


SEATTLE-NORTHWEST SECURITIES CORPORATION

Presentation to:

Alaska School Districts and Municipal Governments Re: TRS and PERS Liability Refinancing

March 2005

Merrill Lynch

Global Markets & Investment Banking Group

Presentation to Alaska School Districts and Municipal Governments - TRS and PERS Liability Refinancing

Table of Contents

1. Executive Summary

Executive Summary

- **House and Senate Hearings:** Over the past month, policymakers have discussed numerous potential solutions to PERS/TRS underfunding. Pension financing is one of many solutions that policymakers have expressed a desire to explore.

- **Growing Local Interest:** Many local entities and school districts are attracted to pension financing solutions. For instance, the Alaska Municipal League recently recommended that the State "consider the creation of a State and Local Retirement Pension Bond Corporation to finance the PERS/TRS $5 Billion past liability with low interest bonds. Estimated bond rates of 5.5 to 6% could save an estimated over $100 million/year on the PERS/TRS unfunded liability currently at 8.25%."

- **High Potential Savings:** With interest rates at today's low levels, the potential savings from a pension financing continue to be very attractive (see section 2).

- **Detailed Risk Assessment:** Regarding risk, history shows that in almost all cases (other than two years in the depth of the stock market crash of 1929-1930), returns of a 70% equity / 30% fixed income portfolio (similar to TRS' current investment allocation) over 20 years would have exceeded today's assumed pension bond rate (see section 3). *Note that past performance does not guarantee future results.*

- **Solid Legal Framework:** Most U.S. jurisdictions have used G.O. bonds to execute these financings, but such a method is not permitted by the Alaska constitution. Merrill Lynch has designed a structure that permits bond financing to occur within a conventional and solid legal framework (see section 4).

- **Next Steps:** We discuss potential next steps in section 5.

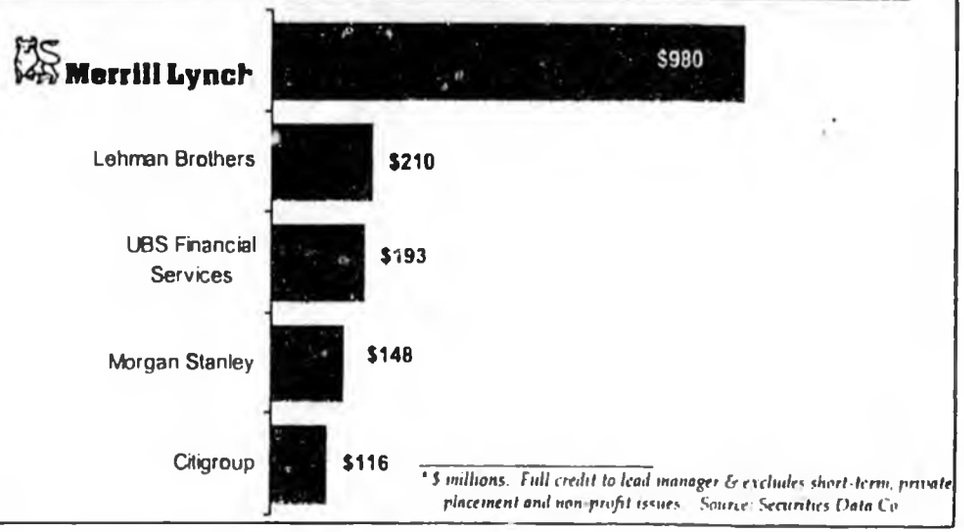
Executive Summary

Merrill Lynch Commitment to the State of Alaska

Merrill Lynch Alaska Retail Presence

- Merrill Lynch has maintained a corporate presence in the State of Alaska since 1976
- 2 retail offices located in Anchorage and Juneau
- Merrill Lynch employs 45 Alaska residents
- 25 Financial Advisors managing nearly 24,000 accounts for retail clients
- $1.8 billion in retail assets and $146 million in municipal bonds
- Merrill Lynch is ranked 2nd among the 7 largest retail firms in the sale of municipal bonds to Alaska retail investors with a 24.8% market share (McLagan Survey First Half 2003)

Alaska Competitive Underwriting Rankings (1990-Present)*



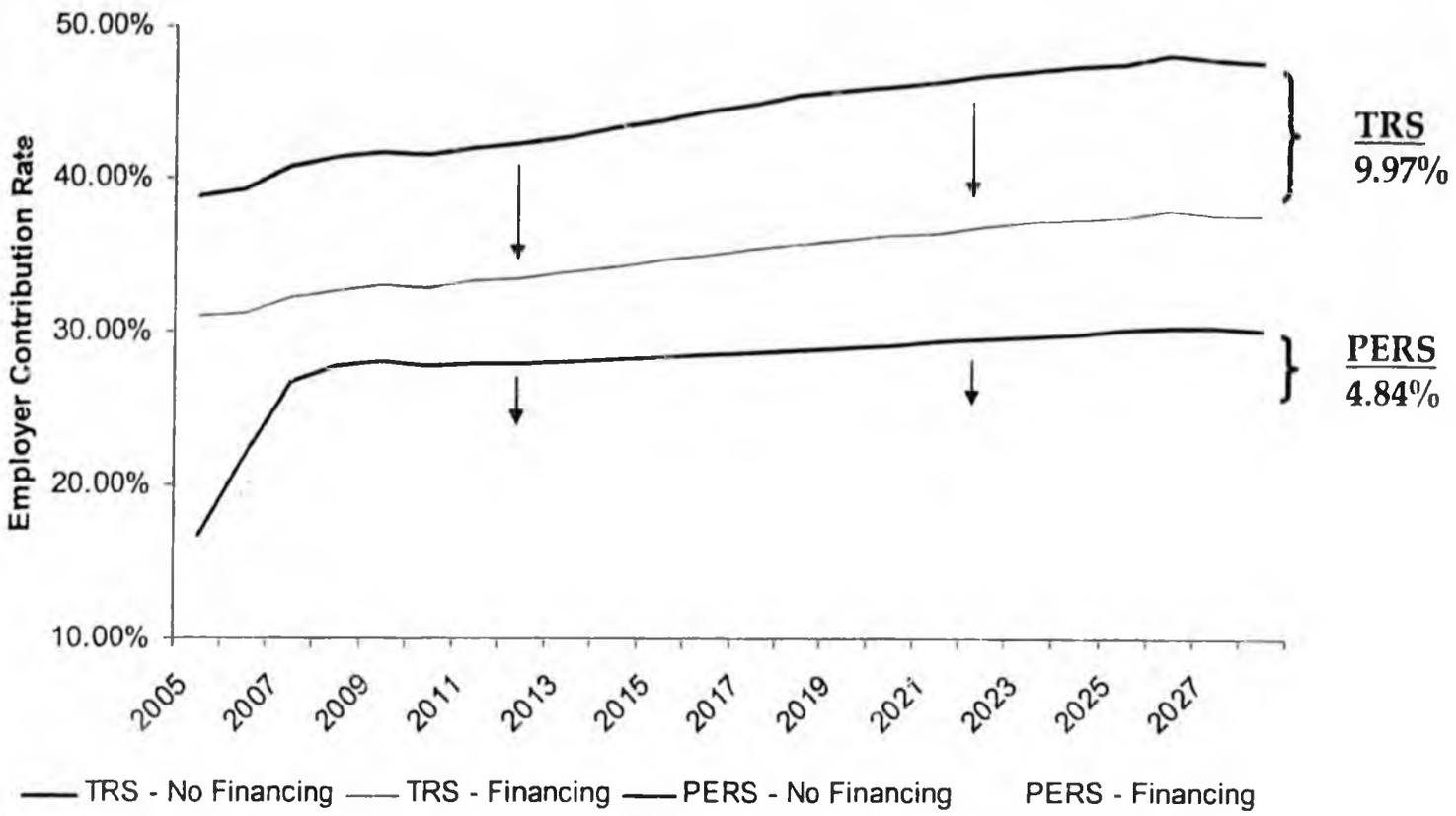
*$ millions. Full credit to lead manager & excludes short-term, private placement and non-profit issues. Source: Securities Data Co

2. Overview of Potential Savings from Pension Financing

Overview of Potential Savings from Pension Financing

Potential Employer Contribution Rate Impact*

Pension financing could drop employer contribution rates for local municipalities and school districts significantly and immediately.



* Please see page 8 of this presentation for important disclosure on our calculation of the numbers on this page.

Overview of Potential Savings from Pension Financing

TRS Analysis

If TRS' Unfunded Accrued Actuarial Liability (UAAL) were refinanced with a bond issue, the financing would show projected PV savings of about $731 million of the $2 billion UAAL.**

EMPLOYER SIZE		POTENTIAL SAVINGS FROM PENSION BOND SOLUTION								
		2007				2028				
2005 TRS Employer Salary	% of Total 2005 TRS Salaries	Actuarial Estimate of Employer Contrib Rate	Employer Contrib Rate w/ Pension Bonds	Decline in Employer Contrib Rate	Decline in Employer Payment	Actuarial Estimate of Employer Contrib Rate	Employer Contrib Rate w/ Pension Bonds	Decline in Employer Contrib Rate	Decline in Employer Payment	Total 2005 - 2028 Employer Payment PV Savings*
$5,000,000	0.87%	40.75%	32.27%	8.48%	$446,966	47.62%	37.65%	9.97%	$1,251,284	$6,382,001
$10,000,000	1.74%	40.75%	32.27%	8.48%	$893,933	47.62%	37.65%	9.97%	$2,502,567	$12,764,002
$25,000,000	4.36%	40.75%	32.27%	8.48%	$2,234,832	47.62%	37.65%	9.97%	$6,256,418	$31,910,004
$50,000.000	8.72%	40.75%	32.27%	8.48%	$4,469,665	47.62%	37.65%	9.97%	$12,512,837	$63,820,008
$100,000,000	17.44%	40.75%	32.27%	8.48%	$8,939,330	47.62%	37.65%	9.97%	$25,025,673	$127,640,015
$200,000,000	34.88%	40.75%	32.27%	8.48%	$17,878,660	47.62%	37.65%	9.97%	$50,051,347	$255,280,030
$573,377,000	100.00%	40.75%	32.27%	8.48%	$51,256,062	47.62%	37.65%	9.97%	$143,491,455	$731,858,490

* PV at 8.25% actuarial rate.

** Please see page 8 of this presentation for important disclosure on our calculation of the numbers on this page.

Overview of Potential Savings from Pension Financing

TRS Analysis****

	TRS Salaries		NO ACTION		PROPOSED PENSION BOND SOLUTION				POTENTIAL SAVINGS-PENSION BOND SOLUTION		
	Entire TRS*	Employer w/ 100.00% of Salaries	Total Employer Ctb Rate** (Normal + Past Svc)	Total Employer Payments (Normal + Past Svc)	Total Employer Ctb Rate*** (Expected Normal Rate)	Total Employer Payments (Expected Normal Rate)	Pension Bond Debt Service to Pre-Fund Past Svc Rate	Total Employer Payments	Decline in Employer Payments	Decline in Employer Ctb. Rate	Improved Total Employer Ctb. Rate
	A	B = A * 100.00%	C	D = B * C	E	F = B * E	G	H = F + G	I = D - H	J = I / B	K = C - J
2005	$573,377,000	$573,377,000	38.85%	$222,756,965	14.76%	$84,630,445	$93,486,831	$178,117,277	$44,639,688	7.79%	31.06%
2006	586,635,000	586,635,000	39.22%	230,078,247	14.28%	83,771,478	99,020,765	182,792,243	47,286,005	8.06%	31.16%
2007	604,620,000	604,620,000	40.75%	246,382,650	14.52%	87,790,824	107,335,765	195,126,589	51,256,062	8.48%	32.27%
2008	623,847,000	623,847,000	41.29%	257,586,426	14.63%	91,250,101	112,575,765	203,825,865	53,760,561	8.62%	32.67%
2009	644,648,000	644,648,000	41.65%	268,495,892	14.73%	94,982,436	117,435,765	212,418,201	56,077,691	8.70%	32.95%
2010	667,202,000	667,202,000	41.53%	277,088,991	14.84%	99,019,449	120,515,765	219,535,213	57,553,777	8.63%	32.90%
2011	691,229,000	691,229,000	41.98%	290,177,934	14.95%	103,324,911	126,460,765	229,785,675	60,392,259	8.74%	33.24%
2012	716,139,000	716,139,000	42.24%	302,497,114	15.06%	107,814,726	131,760,765	239,575,491	62,921,623	8.79%	33.45%
2013	742,797,000	742,797,000	42.75%	317,545,718	15.16%	112,622,881	138,690,765	251,313,646	66,232,072	8.92%	33.83%
2014	771,037,000	771,037,000	43.25%	333,473,503	15.27%	117,729,640	146,015,765	263,745,404	69,728,098	9.04%	34.21%
2015	801,545,000	801,545,000	43.79%	350,996,556	15.38%	123,245,559	154,141,123	277,386,682	73,609,873	9.18%	34.61%
2016	834,288,000	834,288,000	44.32%	369,756,442	15.48%	129,172,811	162,826,123	291,998,934	77,757,508	9.32%	35.00%
2017	869,145,000	869,145,000	44.83%	389,637,704	15.59%	135,499,706	172,001,123	307,500,829	82,136,875	9.45%	35.38%
2018	906,267,000	906,267,000	45.30%	410,538,951	15.70%	142,256,731	181,576,123	323,832,854	86,706,097	9.57%	35.73%
2019	945,445,000	945,445,000	45.68%	431,879,276	15.80%	149,418,128	191,171,123	340,589,251	91,290,025	9.66%	36.02%
2020	986,990,000	986,990,000	45.96%	453,620,604	15.91%	157,039,979	200,726,694	357,766,672	95,853,932	9.71%	36.25%
2021	1,031,829,000	1,031,829,000	46.25%	477,220,913	16.02%	165,278,369	211,121,352	376,399,721	100,821,191	9.77%	36.48%
2022	1,080,428,000	1,080,428,000	46.68%	504,343,790	16.13%	174,219,015	223,431,356	397,650,371	106,693,419	9.88%	36.80%
2023	1,132,136,000	1,132,136,000	47.08%	533,009,629	16.23%	183,768,316	236,367,711	420,136,027	112,873,602	9.97%	37.11%
2024	1,187,212,000	1,187,212,000	47.32%	561,788,718	16.34%	193,978,569	248,933,734	442,912,303	118,876,416	10.01%	37.31%
2025	1,245,623,000	1,245,623,000	47.49%	591,546,363	16.45%	204,855,159	261,712,664	466,567,823	124,978,540	10.03%	37.46%
2026	1,306,908,000	1,306,908,000	48.01%	627,446,531	16.55%	216,332,481	278,243,190	494,575,671	132,870,860	10.17%	37.84%
2027	1,371,207,000	1,371,207,000	47.71%	654,202,860	16.66%	228,443,086	288,155,210	516,598,296	137,604,564	10.04%	37.67%
2028	1,438,671,000	1,438,671,000	47.62%	685,095,130	16.76%	241,121,260	300,482,416	541,603,676	143,491,455	9.97%	37.65%

Total Employer Savings:	$2,055,412,191
PV of Employer Savings @ 8.25%:	$731,858,490

* See Page 32, Table 4, of State of Alaska TRS Actuarial Valuation as of June 30, 2003

** See Page 27, Table 2, of State of Alaska TRS Actuarial Valuation as of June 30, 2003

*** Assumes normal rate grows steadily from today's levels to 16.76% in 2028

**** Please see page 8 of this presentation for important disclosure on our calculation of the numbers on this page

Overview of Potential Savings from Pension Financing

PERS Analysis

If PERS' Unfunded Accrued Actuarial Liability (UAAL) were refinanced with a bond issue, the financing would show projected PV savings of about $1 billion of the $2.8 billion UAAL.**

EMPLOYER SIZE		POTENTIAL SAVINGS FROM PENSION BOND SOLUTION								
		2007				2028				
2005 PERS Employer Salary	% of Total 2005 PERS Salaries	Actuarial Estimate of Employer Contrib Rate	Employer Contrib Rate w/ Pension Bonds	Decline in Employer Contrib Rate	Decline in Employer Payment	Actuarial Estimate of Employer Contrib Rate	Employer Contrib Rate w/ Pension Bonds	Decline in Employer Contrib Rate	Decline in Employer Payment	Total 2005 - 2028 Employer Payment PV Savings*
$5,000,000	0.32%	26.77%	22.43%	4.34%	$233,577	30.22%	25.38%	4.84%	$628,138	$3,152,746
$10,000,000	0.63%	26.77%	22.43%	4.34%	$467,155	30.22%	25.38%	4.84%	$1,256,277	$6,305,493
$25,000,000	1.58%	26.77%	22.43%	4.34%	$1,167,887	30.22%	25.38%	4.84%	$3,140,692	$15,763,732
$50,000,000	3.15%	26.77%	22.43%	4.34%	$2,335,774	30.22%	25.38%	4.84%	$6,281,384	$31,527,465
$100,000,000	6.31%	26.77%	22.43%	4.34%	$4,671,548	30.22%	25.38%	4.84%	$12,562,769	$63,054,929
$250,000,000	15.77%	26.77%	22.43%	4.34%	$11,678,870	30.22%	25.38%	4.84%	$31,406,922	$157,637,323
$500,000,000	31.55%	26.77%	22.43%	4.34%	$23,357,739	30.22%	25.38%	4.84%	$62,813,843	$315,274,645
$1,585,006,000	100.00%	26.77%	22.43%	4.34%	$74,044,314	30.22%	25.38%	4.84%	$199,120,637	$999,424,409

* PV at 8.25% actuarial rate.

** Please see page 8 of this presentation for important disclosure on our calculation of the numbers on this page.

Overview of Potential Savings from Pension Financing

PERS Analysis****

	PERS Salaries		NO ACTION		PROPOSED PENSION BOND SOLUTION				POTENTIAL SAVINGS-PENSION BOND SOLUTION		
	Entire PERS*	Employer w/ 100.00% of Salaries	Total Employer Ctb Rate** (Consol + Past Svc)	Total Employer Payments (Consol + Past Svc)	Total Employer Ctb Rate*** (Expected Consol Rate)	Total Employer Payments (Expected Consol Rate)	Pension Bond Debt Service to Pre-Fund Past Svc Rate	Total Employer Payments	Decline in Employer Payments	Decline in Employer Ctb. Rate	Improved Total Employer Ctb. Rate
	A	B = A * 100.00%	C	D = B * C	E	F = B * E	G	H = F + G	I = D - H	J = I / B	K = C - J
2005	$1,585,006,000	$1,585,006,000	16.77%	$265,805,506	13.31%	$210,964,299	$37,045,386	$248,009,685	$17,795,822	1.12%	15.65%
2006	1,644,687,000	1,644,687,000	21.77%	358,048,360	13.24%	217,756,559	94,768,848	312,525,407	45,522,953	2.77%	19.00%
2007	1,706,759,000	1,706,759,000	26.77%	456,899,384	13.40%	228,721,222	154,133,848	382,855,070	74,044,314	4.34%	22.43%
2008	1,772,065,000	1,772,065,000	27.74%	491,570,831	13.49%	239,083,788	170,553,848	409,637,636	81,933,195	4.62%	23.12%
2009	1,840,407,000	1,840,407,000	27.99%	515,129,919	13.58%	249,977,464	179,108,848	429,086,312	86,043,608	4.68%	23.31%
2010	1,912,174,000	1,912,174,000	27.73%	530,245,850	13.67%	261,463,719	181,563,848	443,027,567	87,218,283	4.56%	23.17%
2011	1,986,893,000	1,986,893,000	27.84%	553,151,011	13.76%	273,486,790	188,913,848	462,400,638	90,750,373	4.57%	23.27%
2012	2,065,722,000	2,065,722,000	27.96%	577,575,871	13.86%	286,215,173	196,813,848	483,029,021	94,546,850	4.58%	23.38%
2013	2,148,151,000	2,148,151,000	28.08%	603,200,801	13.95%	299,588,950	205,088,848	504,677,798	98,523,003	4.59%	23.49%
2014	2,234,922,000	2,234,922,000	28.20%	630,248,004	14.04%	313,722,096	213,813,848	527,535,944	102,712,060	4.60%	23.60%
2015	2,327,596,000	2,327,596,000	28.39%	660,804,504	14.13%	328,846,995	224,238,848	553,085,843	107,718,662	4.63%	23.76%
2016	2,423,538,000	2,423,538,000	28.53%	691,435,391	14.22%	344,605,071	234,283,848	578,888,919	112,546,472	4.64%	23.89%
2017	2,524,705,000	2,524,705,000	28.67%	723,832,924	14.31%	361,285,286	244,898,848	606,184,134	117,648,790	4.66%	24.01%
2018	2,632,258,000	2,632,258,000	28.84%	759,143,207	14.40%	379,069,082	256,738,848	635,807,930	123,335,278	4.69%	24.15%
2019	2,745,982,000	2,745,982,000	29.01%	796,609,378	14.49%	397,942,719	269,298,848	667,241,567	129,367,811	4.71%	24.30%
2020	2,866,296,000	2,866,296,000	29.17%	836,098,543	14.58%	417,984,129	282,433,848	700,417,977	135,680,567	4.73%	24.44%
2021	2,993,733,000	2,993,733,000	29.34%	878,361,262	14.67%	439,289,494	296,593,848	735,883,342	142,477,920	4.76%	24.58%
2022	3,129,150,000	3,129,150,000	29.50%	923,099,250	14.76%	462,004,774	311,468,848	773,473,622	149,625,628	4.78%	24.72%
2023	3,273,542,000	3,273,542,000	29.70%	972,241,974	14.86%	486,299,544	328,253,848	814,553,392	157,688,582	4.82%	24.88%
2024	3,426,878,000	3,426,878,000	29.90%	1,024,636,522	14.95%	512,193,647	346,152,592	858,346,239	166,290,283	4.85%	25.05%
2025	3,587,398,000	3,587,398,000	30.11%	1,080,165,538	15.04%	539,446,821	365,257,592	904,704,413	175,461,125	4.89%	25.22%
2026	3,755,436,000	3,755,436,000	30.34%	1,139,399,282	15.13%	568,129,186	385,892,592	954,021,778	185,377,504	4.94%	25.40%
2027	3,931,345,000	3,931,345,000	30.27%	1,190,018,132	15.22%	598,314,970	399,697,592	998,012,562	192,005,570	4.88%	25.39%
2028	4,115,495,000	4,115,495,000	30.22%	1,243,702,589	15.31%	630,082,285	414,499,668	1,044,581,953	199,120,637	4.84%	25.38%

Total Employer Savings:	$2,873,435,288
PV of Employer Savings @ 8.25%:	$999,424,409

* See Page 37, Table 4, of State of Alaska PERS Actuarial Valuation as of June 30, 2003

** See Page 32, Table 2, of State of Alaska PERS Actuarial Valuation as of June 30, 2003

*** Assumes normal/consolidated rate grows steadily from today's levels to 15.31% in 2028

**** Please see page 8 of this presentation for important disclosure on our calculation of the numbers on this page.

Disclaimer

Please note that the numbers on pages 3-7 of this presentation are Merrill Lynch's best estimate of future pension financing savings and employer contribution rates based on information in the PERS/TRS Actuarial Valuation Report as of June 30, 2003. It should be noted that future employer contribution rates will be calculated by the PERS/TRS actuary, not Merrill Lynch. In addition, future employer contribution rates will be influenced by unpredictable events such as investment portfolio returns, health care cost assumptions and experience, demographic changes, and other factors which impact the funding levels of the PERS/TRS system. For instance, if the PERS/TRS investment portfolio returns less on an average annual basis than the actuarial assumption of 8.25%, future employer contribution rates will likely be higher than the projected employer contribution rates provided in this presentation. In addition, if the proceeds from a pension bond financing earn less on an average annual basis than the interest rate on the pension bonds for the life of the bonds, the entity issuing the pension bonds will be worse off than had it not issued the bonds.

3. Risks of Pension Bond Financings... A Historical Perspective

Risks of Pension Bond Financings...A Historical Perspective

The Real Reason Behind the Decline in Funding Ratios

Increasing liabilities, not declining assets...

- A common misperception is that the dismal stock market returns of 2001/2002 caused most of the current underfunding in the retirement system. In reality, changes in liabilities such as health assumption changes and benefit improvements were some of the largest contributors.

- In contrast, investment underperformance was a relatively small contributor to the retirement system's current underfunding.

Changes in Assets Include:
- Investment performance

Changes in Liabilities Include:
- Health experience
- Health assumption changes
- Plan changes
- Demographic experience
- Non-health changes

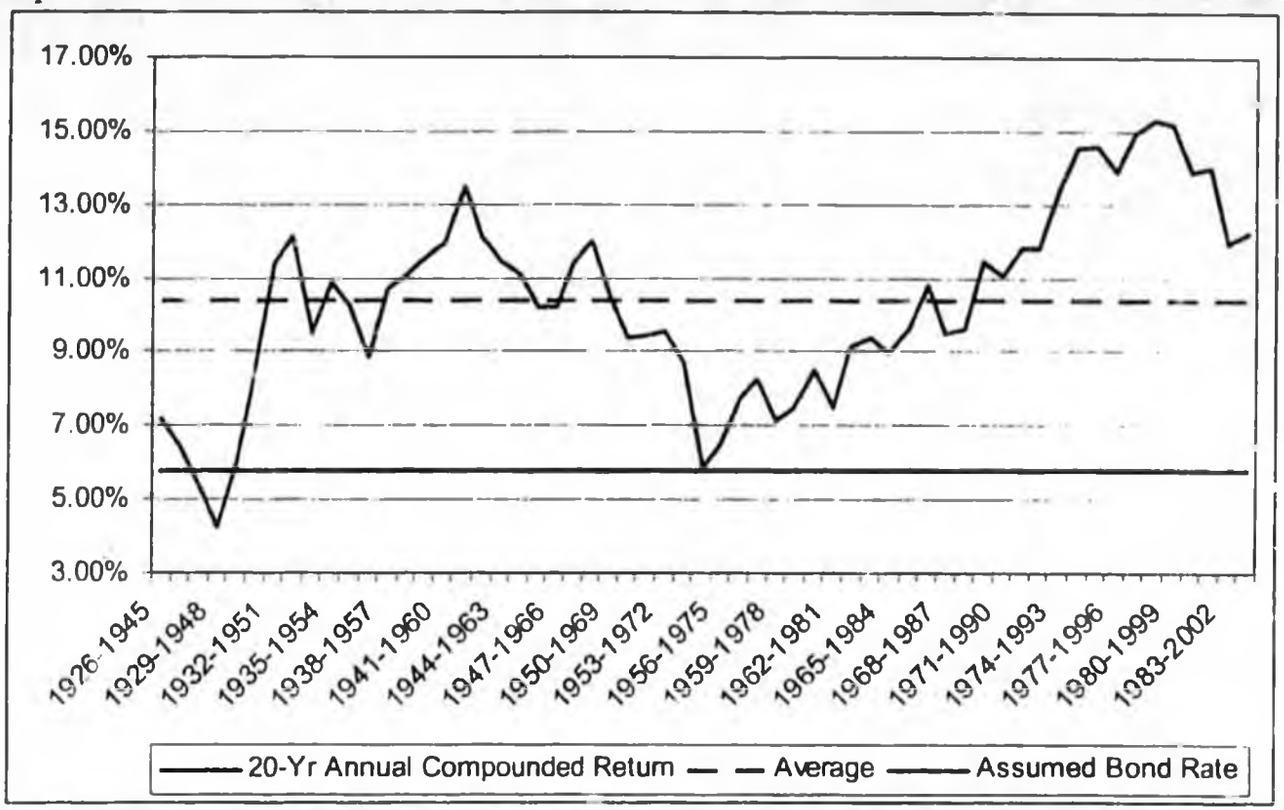
Drivers of PERS/TRS Funding Ratio Changes (1992-2003)		
	PERS Change in Funded Status	TRS Change in Funded Status
Change Due to Assets	-3.8%	-2.7%
Change Due to Liabilities	**-18.5%**	**-26.6%**
Total Change in Funded Status	**-22.3%**	**-29.3%**

Risks of Pension Bond Financings...A Historical Perspective

PERS/TRS Investment Returns vs. Pension Bond Interest Rates

With the exception of two 20-year periods beginning in 1928 and 1929, a 70% stock / 30% bond portfolio since 1926 has always returned more than today's assumed pension bond rate.

Compounded Annual Return Over 20-Year Periods of Portfolio of 70% Stocks and 30% Bonds*



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* Compounded annual returns from Ibbotson Associates "2004 Yearbook". Portfolio comprised of 70% stocks (2/3 large cap and 1/3 small cap) and 30% long-term corporate bonds

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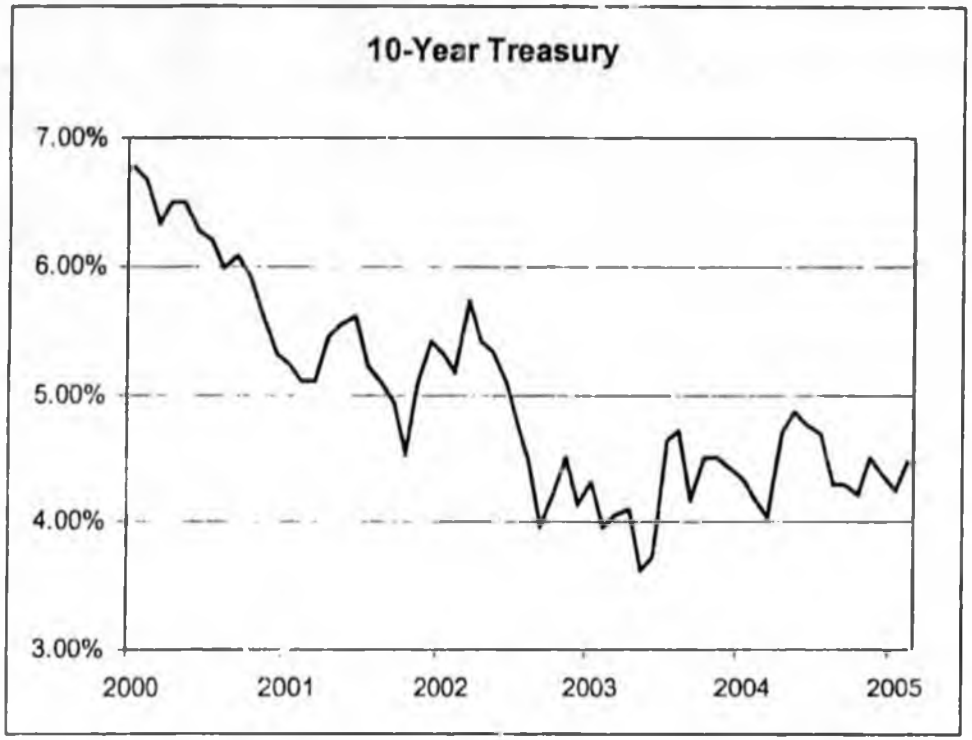
Risks of Pension Bond Financings…A Historical Perspective

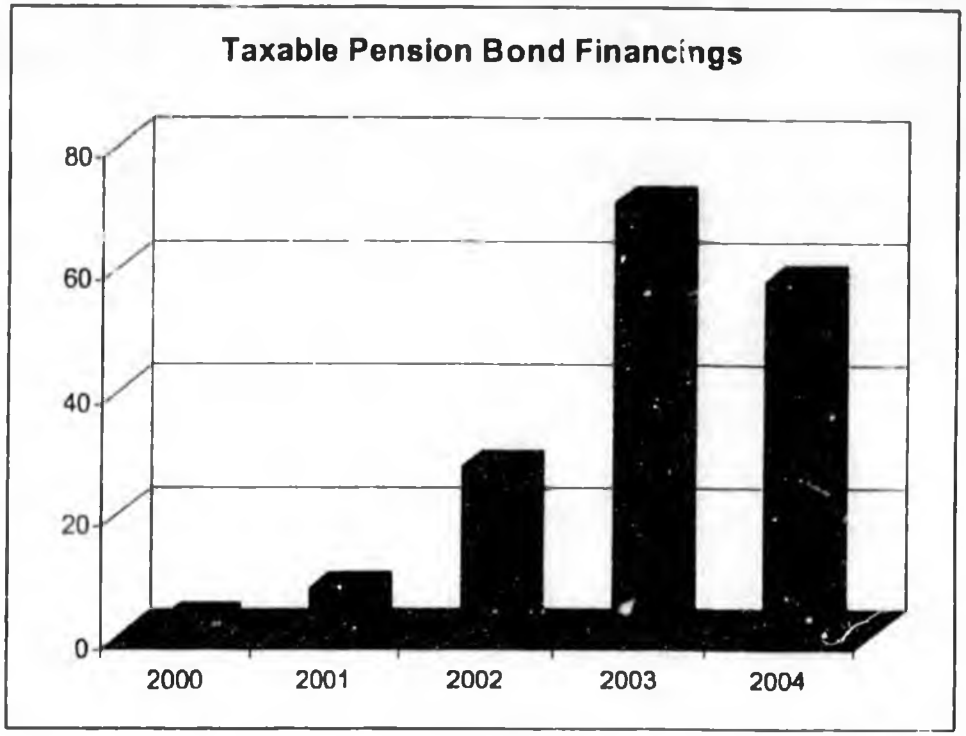
Growth in Pension Financing Solutions

Acceptance of pension financing solutions has grown considerably over the past four years.

As taxable fixed rates have dropped to historic lows…



…pension financing solutions have become common.



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4. Pension Financing Structures

Pension Financing Structures

Problems with Traditional Approaches

Question: How can local governments – school districts, municipalities or municipal enterprises – pre-pay their unfunded accrued actuarial liabilities (UAAL) without incurring debt?

Traditional Approaches:

General Obligation Bonds: State Constitution requires funding a "capital improvement." Of note: many public entities outside of Alaska can use GO Bonds for pension financings.

Revenue Bonds: Require a separable, pledgeable revenue stream. Won't work for general government or schools since the only meaningful revenues those entities have are tax-derived. May work for government enterprises such as utilities (e.g. ML&P).

Pension Financing Structures

Proposed Approach to a Financing

Legal Approach:	**The restrictions on contracting debt contained in Alaska's Constitution are applicable only where the local government has endeavored to borrow money. A contractual obligation to make contributions to a pension fund is not debt.**

Step 1: Enact legislation to form a special-purpose state entity (e.g., the "Alaska Pension Servicing Corp." or "APSC") to service all or a portion of the participating local governments' payments to PERS or TRS related to the local governments' share of the UAAL.

Step 2: Execute contract ("Local Government Pension Servicing Contract") between the participating local governments and the APSC. Key provisions:

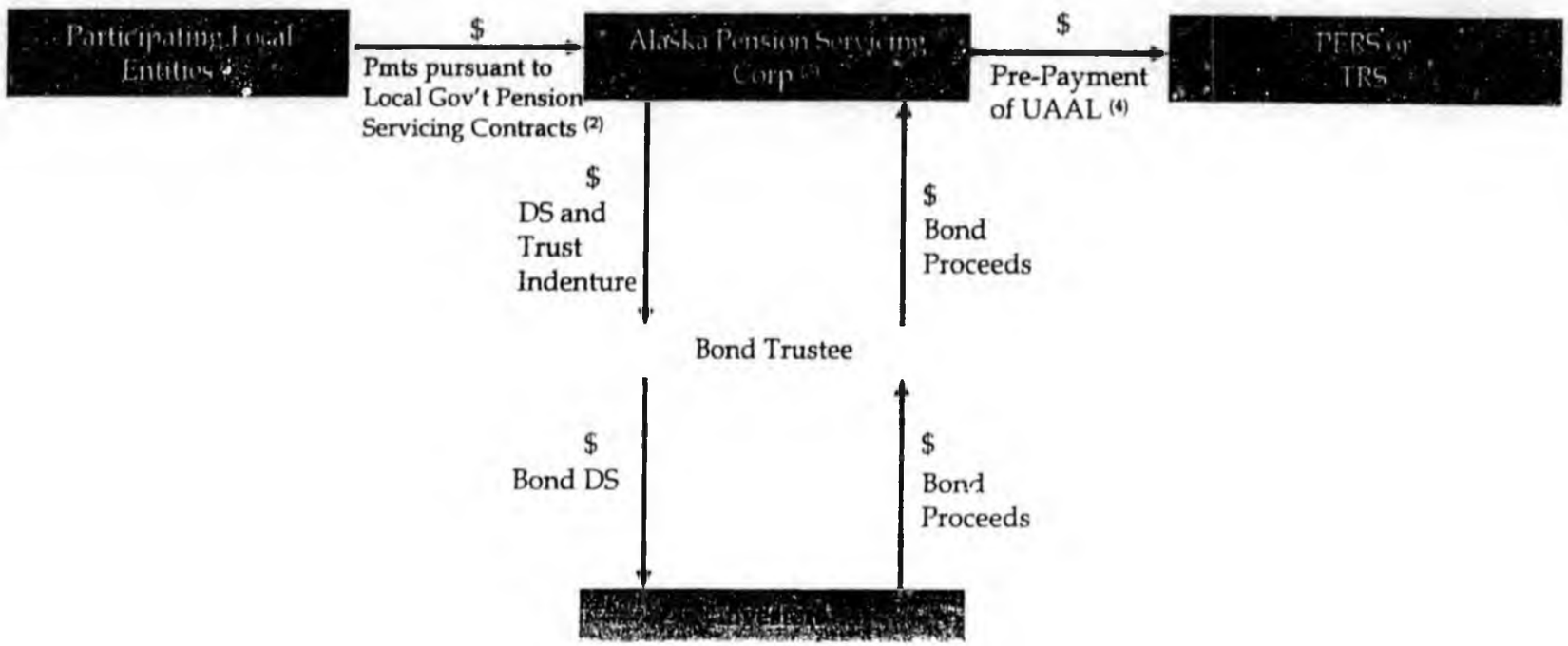
- The APSC agrees to act as a servicer for the local governments;
- The local governments agree to make related payments to the APSC;
- The amount and timing of contractual payments and remedies for failure to pay;
- The APSC agrees to undertake a receivables financing to prepay all or a portion of the local governments' shares of the PERS or TRS UAAL;
- The parties agree that no local government will be responsible for the payments of any other local government; and
- Potentially, include direct deposit mechanism to channel State aid into debt service fund.

Step 3: The APSC issues contract revenue bonds payable solely from APSC's receipts pursuant to each Local Government Pension Servicing Contract.

Step 4: The APSC transfers to PERS or TRS proceeds from contract revenue bonds to prepay all or a portion of the participating local governments' UAALs.

Pension Financing Structures

Proposed Approach to a Financing



1) Government entities with UAAL.

2) Servicing Contract obligates each participating government to make payments to the APSC, and the APSC to issue revenue bonds and to deposit the proceeds with PERS or TERS to prepay UAAL.

3) APSC is a new, special- purpose corporation of the State that can (a) by contract, service obligations of local governments to PERS/TRS; and (b) can issue revenue bonds payable solely from payments received from the local governments.

4) Pre-pay of pension liability of each participant.

Pension Financing Structures

Pension Obligation Bond Security Structures

Survey of Pension Obligation Bond Security Structures

General Obligation	Pension Obligation	Appropriation	Moral Obligation	Dedicated Revenues
Oregon	LA County	New York	Wisconsin	Philadelphia
Pittsburgh	San Diego County	New Jersey		Denver
Indiana[1]	New Orleans			
Illinois	Sacramento County			

- Higher credit quality general obligation bonds are more widely accepted in the marketplace.
- With GO backing not feasible, the bond can be structured as an appropriation credit or a revenue bond structure.

(1) *Bonds secured by underlying pool of municipality GO bonds.*

Rating Agency Perspectives

- The estimated funding ratios of 64% and 73% for TRS and PERS, respectively, as of June 20, 2003 are at very low levels; a pension obligation bond issue demonstrates the Local Entity's intention to address the situation.
  - Large unfunded liability creates the potential for unexpected future cash contributions to the plan.
- Rating agencies will generally view a plan to address the pension liability in a positive light.
  - Given the structural nature of the pension obligation, a bond will not be viewed as an entirely new obligation, but must be part of a reasonable, forward thinking plan to address unfunded pension liability.
  - Careful assessment and appropriate adjustments to actuarial assumptions, benefit increases, and contribution levels can help demonstrate to the rating agencies that the pension bond is part of a comprehensive approach.
- Most issuers of sizeable pension obligation bond programs have not witnessed a resulting decline in ratings.
- The rating agencies are interested in seeing a long-term plan to fund the TRS' and the PERS' unfunded liabilities. A pension obligation bond issue on its own may not fully address analysts' concerns.

5. Work Plan

Work Plan

What Has Happened

What has happened recently...

- **House and Senate Hearings:** Over the past month, Alaska policymakers have discussed numerous potential solutions to PERS/TRS underfunding. Pension financing is one of many solutions that policymakers have expressed a desire to explore.

- **Growing Local Interest:** Many local entities and school districts are attracted to pension financing solutions. For instance, the Alaska Municipal League recently recommended that the State "consider the creation of a State and Local Retirement Pension Bond Corporation to finance the PERS/TRS $5 Billion past liability with low interest bonds. Estimated bond rates of 5.5 to 6% could save an estimated over $100 million/year on the PERS/TRS unfunded liability currently at 8.25%."

- **Tier Restructuring:** Tier restructuring has been discussed as a partial remedy. Most states that have executed bond solutions have done so in conjunction with other programmatic changes (such as Tier restructuring) that helped to get pension funding under control. We believe that, mathematically, our pension financing savings should be available 1-for-1 against whatever Tier restructuring is implemented. Also, a new Tier tends to help more in the far future, whereas the borrowing would have an immediate benefit.

- **Historically Low Rates:** Long-term interest rates have remained at historic lows, making pension bond financings extremely attractive.

- **Increasingly Common Financing Tool:** Municipalities and school districts across the country have increasingly executed pension bond financings and thereby taken advantage of the attractive potential savings levels in today's market. In the past two years alone, there have been 137 taxable pension bond financings in the US.

Work Plan

Next Steps

Going forward, what needs to happen...

- **Continued Development of Legal Structure:** In section 4 we discussed potential legal structures of a pension financing. Next steps would be to work with local counsel and policymakers to formalize the legal structure that would work best for this type of financing.

- **Drafting and Approval of Enabling Legislation:** Merrill Lynch can work with attorneys to draft legislation authorizing a pension bond financing.

Work Plan

Key Features of Legislation

Legislation could be drafted by local counsel to...

- Create Alaska Pension Servicing Corp ("APSC") as a subsidiary of [State Agency].
- Develop necessary governance and assign staff. Most likely would have considerable Board overlap w/ [State Agency], but would need independent directors to preserve necessary independence and bankruptcy protection. Could share accounting, finance and administrative staff with [State Agency].
- Give APSC necessary powers and rights as a government agency to borrow, contract, hire specialists and contractors etc. May draw upon the already enumerated powers of [State Agency] and supplement with additional features as needed.
- Specifically authorize some of the various important features directly associated with the APSC borrowing program. Would authorize APSC to:
    - enter into pension servicing contracts with local governments;
    - pledge portions of those municipal contracts to secure the payment of the bonds in return for bond proceeds;
    - deposit bond proceeds with TRS and PERS boards as appropriate;
    - cooperate with and request help from actuaries; and
    - act on behalf of local governments in making sure proceeds are properly tracked.
- Specifically authorize local governments to contract with the APSC using this structure.

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Presentation to:

State of Alaska:
PERS/TRS Update

Pension Obligation Bonds

January 2006

Global Markets & Investment Banking Group

State of Alaska: PERS/TRS Update
Pension Obligation Bonds

Table of Contents

1. Executive Summary

Executive Summary

Why are we here?

Public employers in the State of Alaska are facing substantial funding shortfalls relative to thei obligations (on an actuarial basis).

Alaska Public Employers PERS/TRS Unfunded Liability as of June 30, 2004*	Present Value
Total PERS	**$3,413 million**
State of Alaska Share	2,023 million
Municipality of Anchorage Share**	462 million
Fairbanks North Star Borough Share***	70 million
City & Borough of Juneau Share	63 million
Remaining 185 Employers Combined	794 million
Total TRS	**$2,278 million**

* Based on Mercer Consulting Actuarial Report.

** Includes both Municipality of Anchorage and Anchorage School District Share

*** Includes both Fairbanks North Star Borough and Fairbanks North Star Borough School District Share

Executive Summary
What is a UAL?

What is a UAL? Actuarial computations compare the costs of future benefits to a projection of assets available to meet those costs. A shortfall is known as an Unamortized Actuarial Liability or UAL.

UAL =

PV of Assumed Future Benefit Costs

Key Drivers:
- Benefit Levels
- Health Care Costs
- Employment / Retiree Patterns

less

PV of Assumed Worth of Past and Ongoing Contributions

Key Drivers:
- Contribution Levels
- Earnings Rates
  - Assumed
  - Actual

=

Executive Summary
Major Points of This Presentation

Section	Key Points
2 What is Pension Financing?	Pension financing is an increasingly common tool that allows municipal issuers to amortize unfunded pension liabilities at a lower interest rate than the rate assumed by actuaries
3 Potential Savings Analysis	The potential present value savings from pension financing are significant:* •System-Wide PERS: $876 million - $1.16 billion (approximately $100 million per year) •System-Wide TRS: $586 - $761 million (approximately $64 million per year)
4 Risk Analysis	Pension financing is not without risk. • The principal financial risk is that the PERS/TRS investment portfolio returns less than the interest rate on the bonds (5.80%) over the 20-30 year life of the bonds. Although history argues against such a dire investment projection, this result is possible • Political developments and/or retirement system changes fundamentally alter landscape
5 Implementation Considerations	The exact legal form of pension financing in Alaska is still unclear. HB278 would provide an approach for local governments to finance on their own or in "pools" via the Bond Bank. Certain issuers may also be able to finance on a stand-alone basis
6 Oregon Example	This technique has been widely employed across the US. In Oregon, the City of Portland issued pension bonds in 1999, other municipalities followed, and finally the State executed a pension financing for its own account in 2003

* Lower end of savings range based on 8.25% PV rate. Higher end of PV savings range based on 5.80% PV rate. Please see page 10 of this presentation for important disclosure of the calculation of the numbers on this page.

2. What is Pension Financing?

What is Pension Financing?

Overview

Description

- All public employers make annual contributions to future benefit costs
- These payments are based on an actuarial evaluation of future costs and go in an account at PERS/TRS
- When value of this account falls below the estimate of future obligations, the difference is known as the UAL
- State-Wide "UAL's":*
  - PERS: $3.4 billion
  - TRS: $2.2 billion

Economics

- The UAL is 'repaid' or amortized to PERS/TRS over 30 years, assuming assets will earn 8.25%
- Effectively, the PERS/TRS account is "lending" the employer the UAL at a loan rate of 8.25%
- With pension financing, the employer borrows, via bonds, money to fund the UAL today. It then repays investors at a rate lower than 8.25%
- In today's market, an employer could borrow at an all-in taxable rate (i.e. interest rate including all financing costs of issuance) of approximately 5.80%

Considerations

- Complexity of analysis and cash flows
- Risk that savings will be less than expected (i.e. investment risk - see section 4)
- Credit rating risk (see section 4)
- Unused technique in Alaska (see sections 4 & 5)
  - Local authority/legal structure
  - Political uncertainty

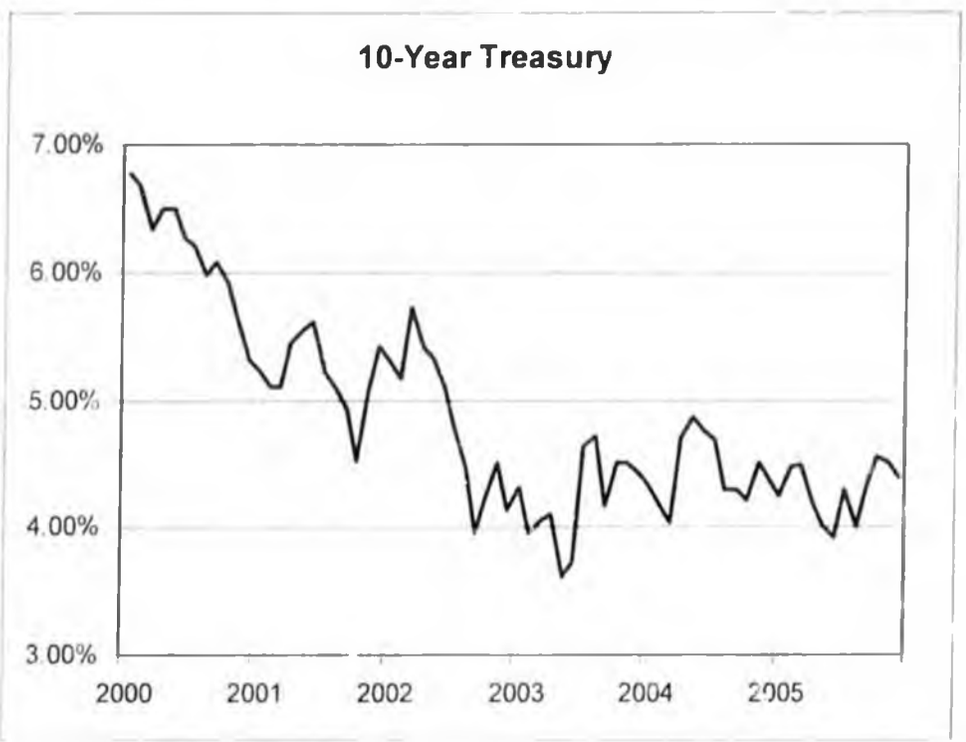
* As of June 2004 based on Mercer Actuarial Report

What is Pension Financing?

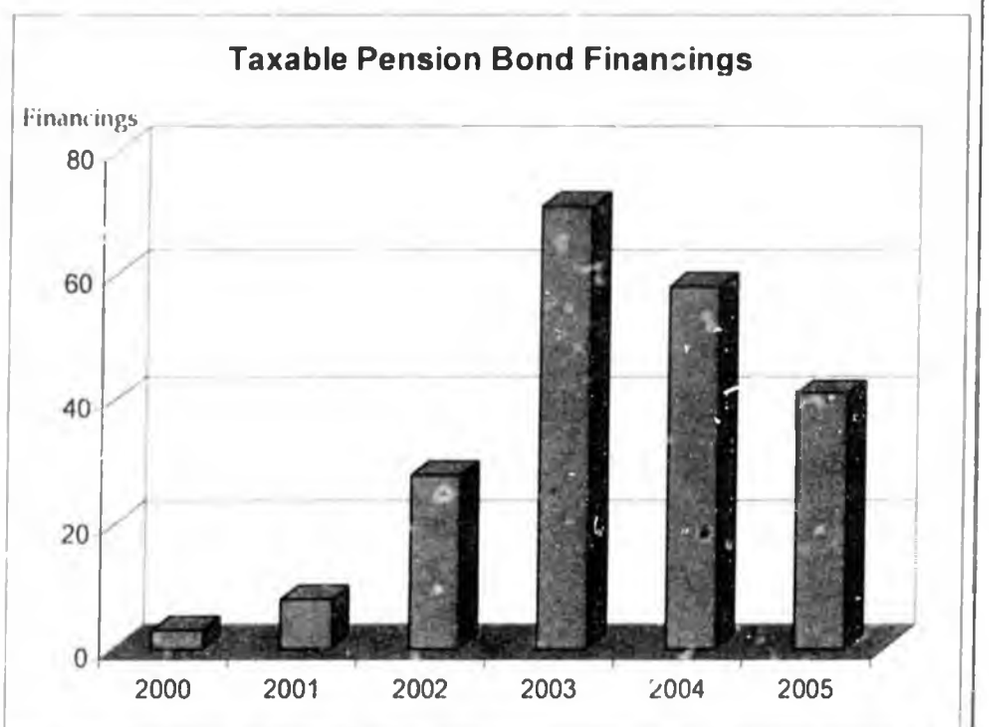
Growth in Pension Financing Solutions

Acceptance of pension financing solutions has grown considerably over the past four years.

As taxable fixed rates have dropped to historic lows...



...pension financing solutions have become common.



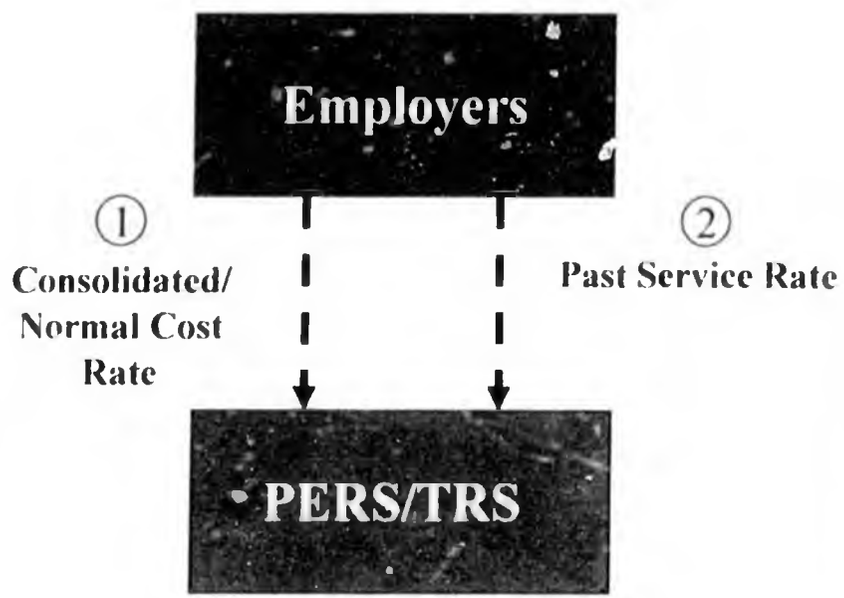
Many other municipalities and states – including Illinois, Wisconsin and Oregon – have implemented pension financings to help solve state-wide underfunding. The City of Portland issued pension bonds in 1999 (senior managed by current Merrill Lynch bankers), after which other municipalities and the State then followed.

3. Potential Savings Analysis

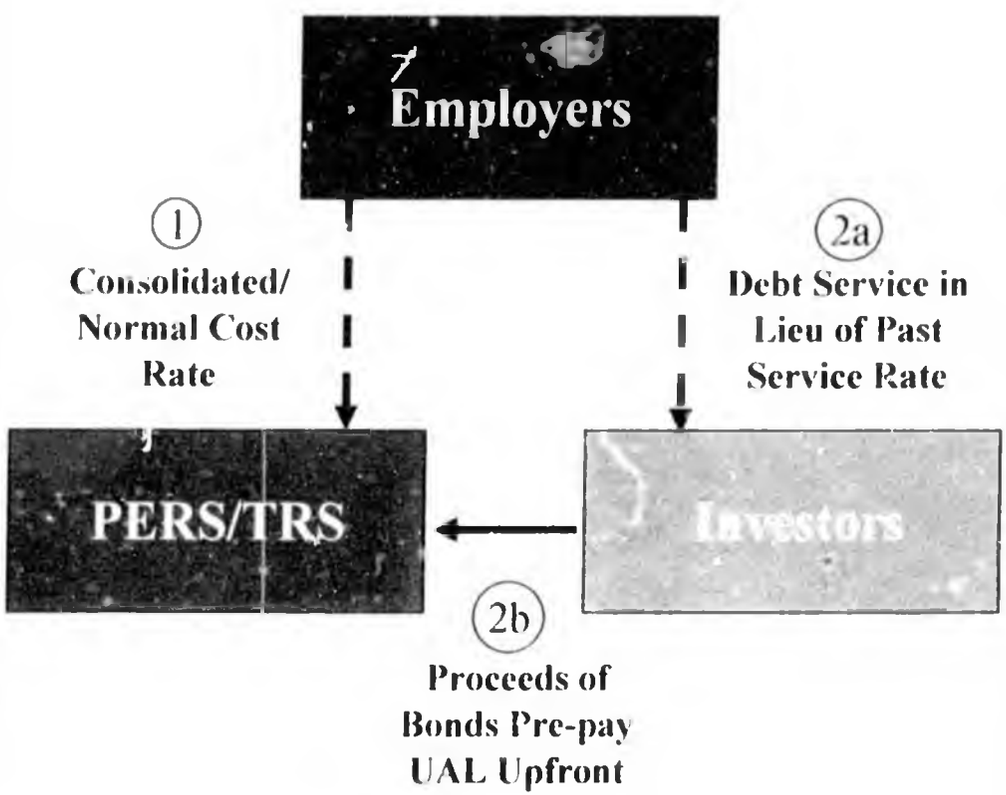
Potential Savings Analysis

UAL Past Service Rate Replaced by Lower-Cost Bond Debt Service

Status Quo



Pension Financing



(1) "Staying Current": Annual cost of future benefits for current and future employees.

(2) "Getting Caught Up": Amortization of past under-funding of future benefits not yet provided for.

Potential Savings Analysis

System-Wide PERS ($3.4 billion UAL)*

2009 Estimated Pension Costs

Status Quo		After Pension Financing	
Consolidated Rate (x):	$233,009,263	Consolidated Rate (x):	$233,009,263
Past Service Rate (y):	$276,932,181	Past Service Rate (y):	N/A
Debt Service on Pension Bonds (z):	N/A	Debt Service on Pension Bonds (z):	$200,192,512
Total Estimated Pension Costs (x+y):	$509,941,444	Total Estimated Pension Costs (x+z):	$433,201,775

2009 Difference: $76.7 million

Estimated Present Value Savings

Status Quo		After Pension Financing	
PV of Past Service Rate:	$3,413,502,000	PV of Debt Service on Pension Bonds:	$2,536,552,430

2006-2030 PV Difference: $876.9 million**

Note that the above numbers are system-wide numbers which assume the entire unfunded liability is financed. The impact for a specific employer would depend on that employer's particular unfunded liability.

** 8.25% PV rate

** Please see page 10 of this presentation for important disclosure on our calculation of the numbers on this page.*

Potential Savings Analysis

System-Wide TRS ($2.2 billion UAL)*

2009 Estimated Pension Costs

Status Quo		After Pension Financing	
Normal Cost Rate (x):	$84,254,490	Normal Cost Rate (x):	$84,254,490
Past Service Rate (y):	$185,900,114	Past Service Rate (y):	N/A
Debt Service on Pension Bonds (z):	N/A	Debt Service on Pension Bonds (z):	$138,290,466
Total Estimated Pension Costs (x+y):	$270,154,603	Total Estimated Pension Costs (x+z):	$222,544,956

2009 Difference: $47.6 million

Estimated Present Value Savings

Status Quo		After Pension Financing	
PV of Past Service Rate:	$2,278,230,000	PV of Debt Service on Pension Bonds:	$1,692,037,245

2006-2030 PV Difference: $586.1 million**

Note that the above numbers are system-wide numbers which assume the entire unfunded liability is financed. The impact for a specific employer would depend on that employer's particular unfunded liability.

** 8.25% PV rate

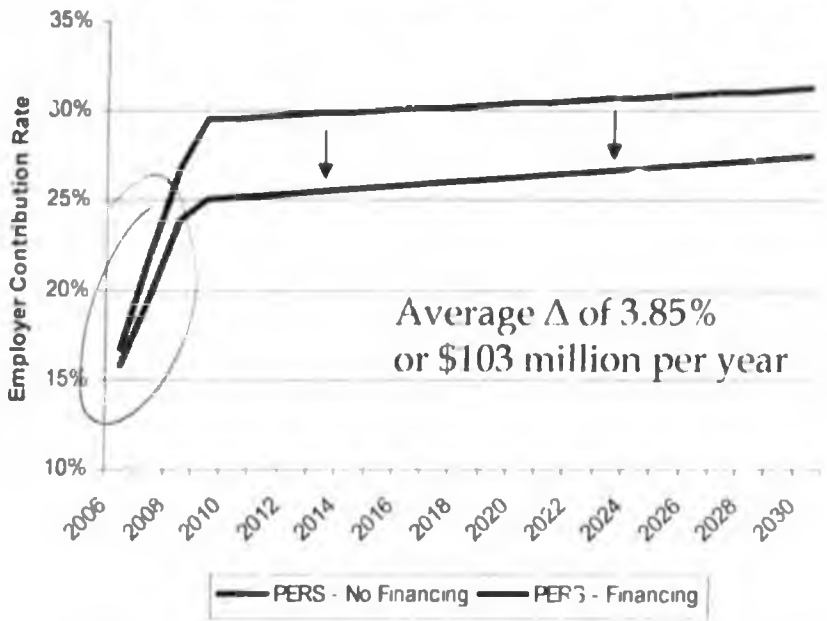
** Please see page 10 of this presentation for important disclosure on our calculation of the numbers on this page.*

Potential Savings Analysis

Potential Employer Contribution Rate Impact*

Pension financing could drop contribution rates for employers significantly and immediately.

System-Wide PERS

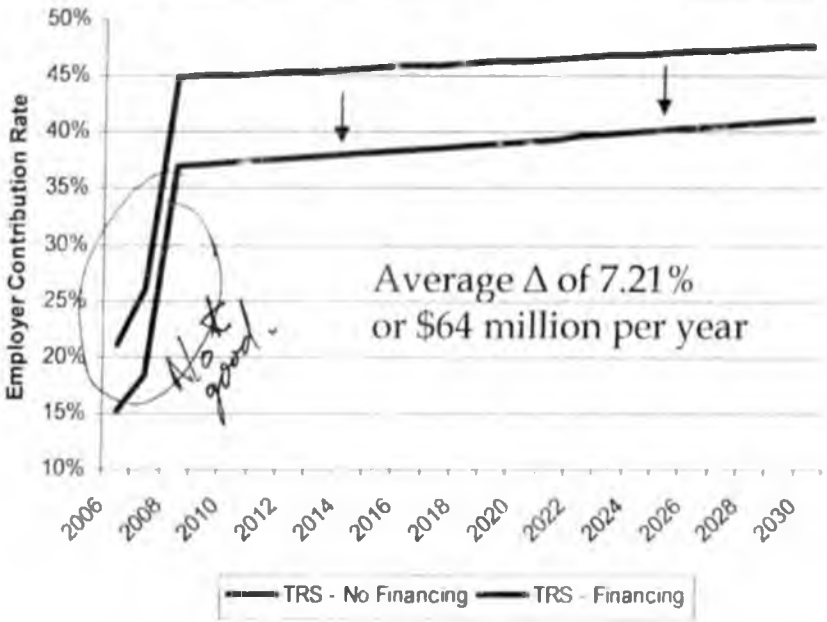


UAL: $3.41 billion

Potential Total Savings: $2.5 billion

Potential PV Savings: $876 million-1.16 billion(1)

System-Wide TRS



UAL: $2.27 billion

Potential Total Savings: $1.6 billion

Potential PV Savings: $586-761 million(1)

Note that the above numbers are system-wide numbers which assume the entire unfunded liability is financed. The impact for a specific employer would depend on that employer's particular unfunded liability.

(1) Lower end of savings range based on 8.25% PV rate. Higher end of PV savings range based on 5.80% PV rate.

* *Please see page 10 of this presentation for important disclosure on our calculation of the numbers on this page.*

Disclaimer

Please note that the numbers on pages 3, 7-9, and 26-29 of this presentation are Merrill Lynch's best estimate of future pension financing savings and employer contribution rates based on information in the PERS/TRS Actuarial Valuation Report as of June 30, 2004 (including supplemental report). It should be noted that future employer contribution rates will be calculated by the PERS/TRS actuary, not Merrill Lynch. In addition, future employer contribution rates will be influenced by unpredictable events such as investment portfolio returns, health care cost assumptions and experience, demographic changes, and other factors which impact the funding levels of the PERS/TRS system. For instance, if the PERS/TRS investment portfolio returns less on an average annual basis than the actuarial assumption of 8.25%, future employer contribution rates will likely be higher than the projected employer contribution rates provided in this presentation. In addition, if the proceeds from a pension bond financing earn less on an average annual basis than the interest rate on the pension bonds for the life of the bonds, the entity issuing the pension bonds could be worse off than had it not issued the bonds.

4. Risk Analysis

Risk Analysis

Key Variables Underlying UAL Calculation

Paying off the UAL is the fundamental objective. What key drivers could change the UAL?

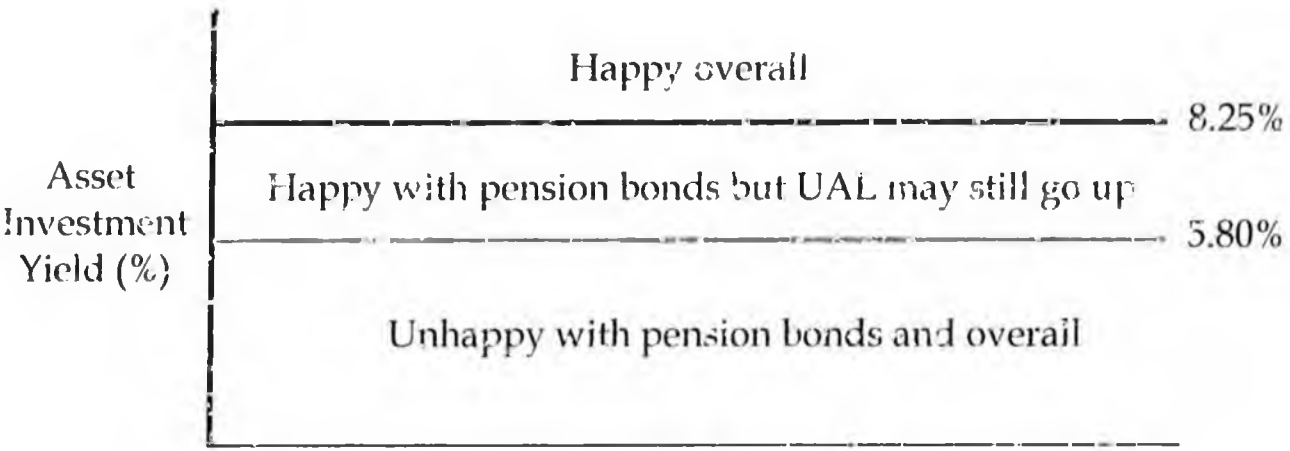
	Description	Considerations
Cost of Benefits Assumptions	How much will it cost to provide benefits in the future?	• Medical benefit cost growth has been a major factor
Assumed Earnings Rate	What investment rate does actuary assume will be earned?	• Current assumed rate for PERS/TRS is 8.25%
Actual Earnings Rate	What investment rate will asset actually earn?	• No certainty. Only assumptions based on historical returns. See historical averages on page 15

Risk Analysis

How do we evaluate financial success of a financing approach?

Is it important to identify incremental risk associated with the financing.

- The PERS System has net assets of $8.59 billion and the TRS System has net assets of $4.02 billion
  - All other things equal, when those assets earn < 8.25%, the UAL goes up
- In a bond scenario, you finance your contribution at 5.80% in today's market
  - As long as those bond-funded assets earn more than 5.80%, you are better off for having borrowed



Risk Analysis

Summary of Other Key Risks

	Description	Considerations
Investment Risk	Risk that proceeds contributed upfront could earn less than the bond rate	• Historic investment performance • Historically low borrowing rate • See next two slides
Credit Risk	Risk that additional debt could negatively impact bond credit ratings	• Rating agencies support well-structured pension finance programs (see page 16)
Financing Risk	Customary financial market risks; market timing; disclosure; staff time	• No different than any other financing undertaken for savings, with exception of higher financing costs due to new and more complex credit
Political Risk	Risk of an individual employer taking the lead ahead of a Statewide solution	• What if an employer borrows and State funds UAL later through bonds or cash contribution? • What if State provides credit support to pension bonds after an employer sells bonds?

Risk Analysis

Investment Risk

Between 1992 and 2003, increasing liabilities—not poor investment performance—caused the most damage to the PERS/TRS system.

Changes in Assets Include:

- Investment performance (i.e. investment risk)

Changes in Liabilities Include:

- Health benefits cost experience
- Health assumption changes
- Plan changes
- Demographic experience
- Non-health changes

Drivers of PERS/TRS Funding Ratio Changes (1992-2003)

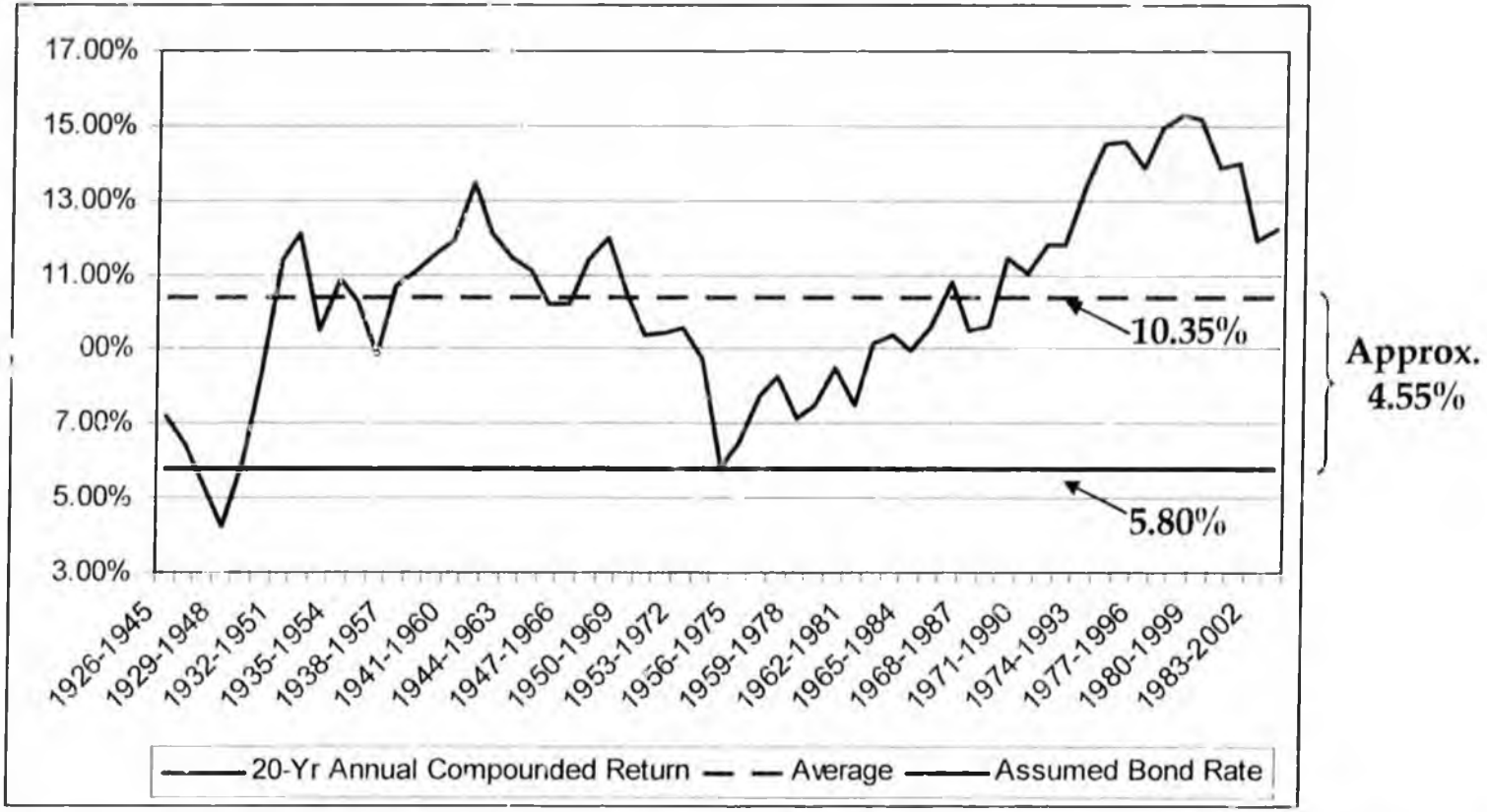
	PERS Change in Funded Status	TRS Change in Funded Status
Change Due to Assets	[illegible]	[illegible]
Change Due to Liabilities	**-18.5%**	**-26.6%**
Total Change in Funded Status	**-22.3%**	**-29.3%**

***Key Takeaway:* the poor stock market was NOT the driving force behind the underfunding of the retirement system.**

Risk Analysis
Investment Risk

As long as the bond proceeds that are invested in PERS/TRS yield more (over the 20-30 year life of the bonds) than the bond rate, you are better off financially for having borrowed.

Compounded Annual Return Over 20-Year Periods of Portfolio of 70% Stocks and 30% Bonds*



With the exception of the 20-year periods beginning in 1928 and 1929, a 70% stock / 30% bond portfolio since 1926 has always returned more than today's assumed pension bond rate.

* Compounded annual returns from Ibbotson Associates "2004 Yearbook". Portfolio comprised of 70% stocks (2/3 large cap and 1/3 small cap) and 30% long-term corporate bonds.

Risk Analysis

Credit Risk: Does pension financing damage credit ratings?

Rating Agency Perspectives

- **Common Tool:** Over 160 taxable pension financings in past 3 years, which are helpful case studies on credit impact.

- **Maintenance of Existing Ratings Common:** Pension bonds simply replace the "soft" future liability of high employer contributions with a "hard" future liability of bond debt payments. To maintain ratings, issuers must:
  - Structure pension bonds conservatively to achieve equal employer savings over time;
  - Use conservative actuarial assumptions in their savings calculations;
  - Incorporate pension bonds as one tool of a larger, comprehensive pension plan;
  - Example: City of Portland maintained AAA GO rating and Aa2 limited-tax rating after pension bonds.

- **Limited Potential for Adverse Credit Impact:** Illinois downgraded to credit "negative" by S&P and downgraded from Aa2 to Aa3 by Moody's. S&P cited numerous reasons for downgrade, including "a reliance on *one-time revenues, including $2 billion in pension obligation bonds*, to balance the 2003 and 2004 budgets." ***That said, downgrade would likely have happened even without pension bonds.***

5. Implementation Considerations

Implementation Considerations

Bond Funding Solutions

Question: How can local governments – school districts, municipalities or municipal enterprises – pre-pay their unfunded accrued actuarial liabilities (UAL) without incurring "debt"?

Traditional Approaches:

General Obligation Bonds: State Constitution requires funding a "capital improvement." Of note: many public entities outside of Alaska can use GO Bonds for pension financings.

Revenue Bonds: Require a separable, pledgeable revenue stream.

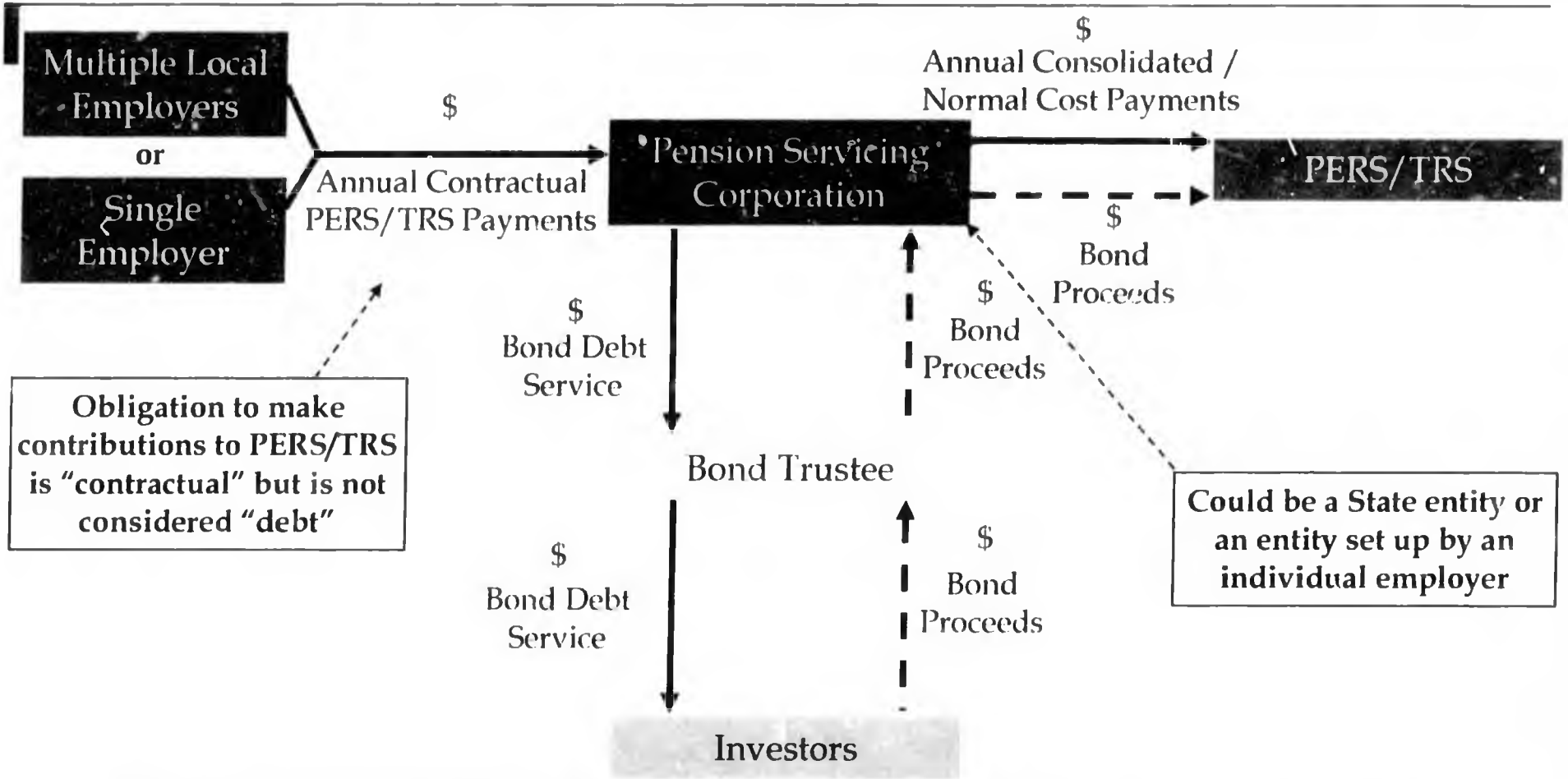
Potential Solutions:

Debt Issued Via Funding Conduit: ***Local contributions to PERS/TRS not considered debt.*** Municipalities agree to make annual PERS/TRS payments to funding conduit. Funding conduit sells pension bonds. Pension bond proceeds pre-fund accrued liabilities. Funding conduit divides those payments between those going to debt service on bonds and payments to PERS/TRS. Conduit could be State-wide or created by an individual employer.

Appropriation Bonds By Larger, Well-Rated Municipalities: It is debatable, but some lawyers do not consider appropriation-backed debt to be GO debt, since debt payments are not based on full faith and credit of municipality.

Implementation Considerations

Debt Issued Via Funding Conduit



Representative Hawker introduced House Bill No. 278 (included as Appendix B) last April which would make the Bond Bank the "Pension Servicing Corporation" (red box above) for multiple local entities. The bill will remain active in the upcoming session. Certain employers such as the Municipality of Anchorage would probably not need the Bond Bank if it chose to issue pension bonds on its own.

Implementation Considerations

Key Aspects of House Bill No. 278

- Entitles Bond Bank or Bond Bank Subsidiary to assist government employers by issuing bonds to enable employers to pre-pay unfunded liabilities of retirement systems.
- Authorizes government employers to contract with—and to issue bonds, notes, or commercial paper to—the Bond Bank or Bond Bank Subsidiary for that purpose.
- Specifies no expectation of subsidization with State funds.
- Consolidated bond-based approach provides municipalities with unified solution.
- Bonds issued by the Bond Bank are additionally secured by a Moral Obligation of the State. That said, none of our discussions with the State have contemplated a State moral obligation to back local pension bonds.

Implementation Considerations

Next Steps

- Respond to feedback from legislators and government officials, further refine analysis
- Develop detailed legal approach
- Discuss HB278 with legislators
- Discuss with Department of Revenue

6. Oregon Example

Oregon Example

Case Study: Pension Obligation Finance in Oregon

Over $6.2 billion of pension obligation bonds have been issued in Oregon since 1999

- A wide range of public employers have issued pension bonds:
  - The State
  - The City of Portland
  - Multnomah County (the County that Portland sits in)
  - School Districts
  - Port of Portland
- In Oregon, UAL's were driven by:
  - Changes in taxability of benefits
  - Mismatched investment options: employee vs. employer contributions
  - Increased cost of benefits
- A variety of alternatives have been used including stand alone and pooled financings and fixed and variable debt

Oregon Example

The City of Portland's Approach

The City issued $350 million of pension bonds in 1999

- At the time, the City's UAL had roughly doubled to $260 million over a two year period
- Portland's contribution rate was slated to increase by roughly 7%
- Given the strong stock market at the time and then-current low borrowing rates, the City chose to issue POBs
- At the time, the stock market had enjoyed a strong run and borrowing rates were attractive

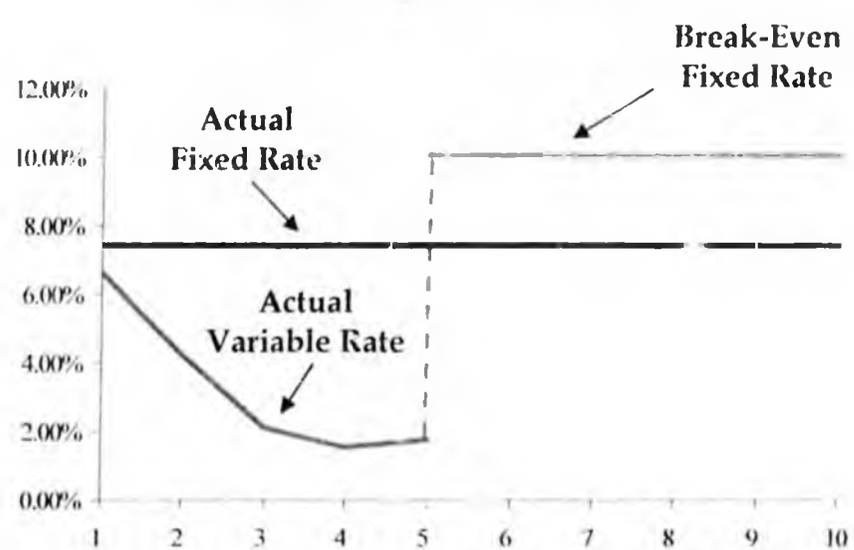
Oregon Example

The City of Portland's Results

The City funded 100% of their UAL with a combination of fixed and variable rate debt

- Debt service was structured to mirror the annually-increasing employer contribution schedule
- The City chose to structure its savings in the early years to mitigate an otherwise large initial jump
- Variable rate debt was issued to minimize the overall cost of funds
- The City has closely monitored its savings

Floating Rate vs. Fixed Rate



Oregon Example

Pooled Local Governments and the State Issue POBs

Since the City's financing, Multnomah County, the State and many local governments have followed suit

- Pension reform in Oregon corrected the "money match" mismatch in 2001 and provided a less costly successor plan for future employees
- Legislation was also passed which allowed for localities to form pools for the purposes of issuing pension bonds
- POBs totaling over $5.9 billion have been issued since 1999 for Multnomah County, pools of school districts, small cities and districts and the State
- As more pension paper has been issued locally and nationally, overall spreads have come down from roughly 2% over Treasuries to 1% over

Oregon Example

Lessons Learned

The Oregon case shows that a POB market can develop quickly in a state with substantive systematic issues

- Political leadership was required by the City of Portland
- A strong, credit-worthy entity can finance on its own
- The pooled approach works but primarily benefits smaller, less credit-worthy and less sophisticated issuers
- The economic benefits of this approach, though never guaranteed, have materialized for Portland

Appendix A: Detailed Savings Analysis

Appendix A: Detailed Savings Analysis

System-Wide PERS Analysis*

		NO ACTION					PROPOSED PENSION BOND SOLUTION				POTENTIAL SAVINGS	
	Salaries/ Earnings (1)	Employer Consolidated Rate (2)	Employer Past Service Rate (3)	Total Employer Contribution Rate	Adjusted Employer Contribution Rate (4)	Total Employer Payments	Employer Consolidated Rate (2)	Employer Consolidated Payments	Pension Bond Debt Service to Pre-Fund Past Svc Rate	Total Employer Payments	Decline in Employer Payments	Decline in Employer Ctb. Rate
	A	B	C	D = B + C	E = D (5% Cap)	F = A * E	G = B	H = A * G	I	J = H + I	K = F - J	L = K / A
2006	$1,527,758,000	13.24%	12.39%	25.63%	16.77%	$256,205,017	13.24%	$202,275,159	$39,257,909	$241,533,068	$14,671,949	0.96%
2007	1,593,097,000	13.32%	15.40%	28.72%	21.77%	346,817,217	13.32%	212,253,624	98,143,878	310,397,502	36,419,715	2.29%
2008	1,659,336,000	13.41%	15.86%	29.27%	26.77%	444,204,247	13.41%	222,461,646	174,383,878	396,845,524	47,358,723	2.85%
2009	1,727,274,000	13.49%	16.03%	29.52%	29.52%	509,941,444	13.49%	233,009,263	200,192,512	433,201,775	76,739,669	4.44%
2010	1,797,014,000	13.57%	16.03%	29.61%	29.61%	532,028,229	13.57%	243,914,700	208,862,512	452,777,212	79,251,016	4.41%
2011	1,868,553,000	13.66%	16.03%	29.69%	29.69%	554,765,362	13.66%	255,182,055	217,792,512	472,974,567	81,790,795	4.38%
2012	1,944,093,000	13.74%	16.03%	29.77%	29.77%	578,812,941	13.74%	267,113,378	227,232,512	494,350,890	84,462,051	4.34%
2013	2,022,803,000	13.82%	16.03%	29.86%	29.86%	603,932,863	13.82%	279,618,801	237,092,512	516,711,313	87,221,550	4.31%
2014	2,105,750,000	13.91%	16.03%	29.94%	29.94%	630,452,508	13.91%	292,839,633	247,502,512	540,342,145	90,110,363	4.28%
2015	2,193,906,000	13.99%	16.03%	30.02%	30.02%	658,674,291	13.99%	306,927,449	258,582,512	565,509,961	93,164,329	4.25%
2016	2,285,874,000	14.07%	16.03%	30.11%	30.11%	688,190,650	14.07%	321,698,668	270,172,512	591,871,180	96,319,470	4.21%
2017	2,383,053,000	14.16%	16.03%	30.19%	30.19%	719,433,468	14.16%	337,360,870	282,437,512	619,798,382	99,635,086	4.18%
2018	2,485,789,000	14.24%	16.03%	30.27%	30.27%	752,520,516	14.24%	353,976,354	295,422,512	649,398,866	103,121,650	4.15%
2019	2,594,418,000	14.32%	16.03%	30.36%	30.36%	787,567,684	14.32%	371,607,138	309,182,512	680,789,650	106,778,034	4.12%
2020	2,708,492,000	14.41%	16.03%	30.44%	30.44%	824,453,335	14.41%	390,203,414	323,662,512	713,865,926	110,587,408	4.08%
2021	2,829,672,000	14.49%	16.03%	30.52%	30.52%	863,698,066	14.49%	410,019,473	339,072,512	749,091,985	114,606,081	4.05%
2022	2,958,569,000	14.57%	16.03%	30.61%	30.61%	905,506,648	14.57%	431,162,122	355,485,357	786,647,479	118,859,169	4.02%
2023	3,095,433,000	14.66%	16.03%	30.69%	30.69%	949,975,096	14.66%	453,687,297	372,941,920	826,629,217	123,345,879	3.98%
2024	3,240,508,000	14.74%	16.03%	30.77%	30.77%	997,198,414	14.74%	477,650,879	391,480,000	869,130,879	128,067,535	3.95%
2025	3,394,392,000	14.82%	16.03%	30.86%	30.86%	1,047,381,649	14.82%	503,162,041	411,180,000	914,342,041	133,039,609	3.92%
2026	3,559,091,000	14.91%	16.03%	30.94%	30.94%	1,101,167,473	14.91%	530,541,832	432,295,000	962,836,832	138,330,641	3.89%
2027	3,733,911,000	14.99%	16.03%	31.02%	31.02%	1,158,367,623	14.99%	559,713,259	454,750,000	1,014,463,259	143,904,364	3.85%
2028	3,917,003,000	15.07%	16.03%	31.11%	31.11%	1,218,432,247	15.07%	590,422,919	478,330,000	1,068,752,919	149,679,328	3.82%
2029	4,110,532,000	15.16%	16.03%	31.19%	31.19%	1,282,057,280	15.16%	623,019,633	503,310,000	1,126,329,633	155,727,647	3.79%
2030	4,314,589,000	15.24%	16.03%	31.27%	31.27%	1,349,297,273	15.24%	657,543,364	529,705,000	1,187,248,364	162,048,910	3.76%

Total Employer Savings:	$2,575,240,971
PV of Employer Savings @ 5.80%:	$1,161,905,490
PV of Employer Savings @ 8.25%:	$876,949,570

Adjusted Employer Contribution Rate lower than Total Employer Contribution Rate due to 5% growth cap, thereby increasing unfunded liability

(1) Salaries/earnings based on 2004 Mercer PERS Report, Page 33, Table 2

(2) Consolidated Rate is an estimate based on conversation with Mercer. Needs to be validated by actuary. Does not impact potential savings from financing

(3) 2006 Past Service Rate based on 2004 Mercer PERS Report, Page 3. After 2006, Past Service Rates assume $3.4 billion unfunded liability from 2004 Mercer PERS report is amortized over 25 years (2006-2030) at 8.25%. In addition, after 2006, in years when the Total Employer Contribution Rate exceeds the Adjusted Employer Contribution Rate (due to the 5% annual cap), the resulting growth in the unfunded liability is amortized through 2030 at 8.25%

(4) 2006 and 2007 Adjusted Employer Contribution Rate based on 2004 Mercer PERS Report, Page 3. After 2006, can grow maximum 5% per year.

Please see page 10 of this presentation for important disclosure on our calculation of the numbers on this page.

Appendix A: Detailed Savings Analysis

System-Wide TRS Analysis*

		NO ACTION					PROPOSED PENSION BOND SOLUTION				POTENTIAL SAVINGS	
	Salaries/ Earnings (1)	Employer Normal Cost Rate (2)	Employer Past Service Rate (3)	Total Employer Contribution Rate	Adjusted Employer Contribution Rate (4)	Total Employer Payments	Employer Normal Cost Rate (2)	Employer Normal Cost Payments	Pension Bond Debt Service to Pre-Fund Past Srv Rate	Total Employer Payments	Decline in Employer Payments	Decline in Employer Ctb. Rate
	A	B	C	D = B + C	E = D	F = A * E	G = B	H = A * G	I	J = H + I	K = F - J	L = K / A
2006	$548,534,000	14.28%	24.57%	38.85%	21.00%	$115,192,140	14.28%	$78,330,655	$5,119,100	$83,449,755	$31,742,385	5.79%
2007	562,254,000	13.76%	29.75%	43.51%	26.00%	146,186,040	13.76%	77,366,150	25,595,466	102,961,616	43,224,424	7.69%
2008	580,874,000	13.89%	30.94%	44.83%	44.83%	260,384,026	13.89%	80,685,924	133,290,466	213,976,390	46,407,635	7.99%
2009	600,922,000	14.02%	30.94%	44.96%	44.96%	270,154,603	14.02%	84,254,490	138,290,466	222,544,956	47,609,648	7.92%
2010	622,528,000	14.15%	30.94%	45.09%	45.09%	280,679,937	14.15%	88,095,832	143,680,466	231,776,298	48,903,640	7.86%
2011	645,548,000	14.28%	30.94%	45.22%	45.22%	291,901,011	14.28%	92,195,481	149,425,466	241,620,947	50,280,064	7.79%
2012	669,523,000	14.41%	30.94%	45.35%	45.35%	303,615,211	14.41%	96,492,819	155,420,466	251,913,285	51,701,925	7.72%
2013	694,825,000	14.54%	30.94%	45.48%	45.48%	315,995,452	14.54%	101,045,681	161,755,466	262,801,147	53,194,305	7.66%
2014	721,832,000	14.67%	30.94%	45.61%	45.61%	329,219,330	14.67%	105,914,723	168,525,466	274,440,189	54,779,140	7.59%
2015	751,052,000	14.80%	30.94%	45.74%	45.74%	343,525,871	14.80%	111,181,820	175,850,466	287,032,286	56,493,585	7.52%
2016	782,222,000	14.93%	30.94%	45.87%	45.87%	358,803,098	14.93%	116,816,353	183,670,466	300,486,819	58,316,279	7.46%
2017	815,519,000	15.06%	30.94%	46.00%	46.00%	375,140,061	15.06%	122,852,619	192,035,466	314,888,085	60,251,977	7.39%
2018	850,831,000	15.19%	30.94%	46.13%	46.13%	392,493,418	15.19%	129,281,921	200,915,466	330,197,387	62,296,031	7.32%
2019	888,381,000	15.33%	30.94%	46.26%	46.26%	410,974,215	15.33%	136,145,320	210,375,466	346,521,786	64,452,430	7.26%
2020	927,943,000	15.46%	30.94%	46.39%	46.39%	430,486,365	15.46%	143,419,642	220,365,466	363,785,108	66,701,257	7.19%
2021	970,814,000	15.59%	30.94%	46.52%	46.52%	451,641,130	15.59%	151,311,914	231,195,466	382,507,380	69,133,749	7.12%
2022	1,017,069,000	15.72%	30.94%	46.65%	46.65%	474,486,447	15.72%	159,847,870	242,890,466	402,738,336	71,748,110	7.05%
2023	1,066,441,000	15.85%	30.94%	46.78%	46.78%	498,910,648	15.85%	168,998,442	255,390,466	424,388,908	74,521,740	6.99%
2024	1,119,075,000	15.98%	30.94%	46.91%	46.91%	524,993,955	15.98%	178,798,992	268,745,000	447,543,992	77,449,963	6.92%
2025	1,174,889,000	16.11%	30.94%	47.04%	47.04%	552,710,555	16.11%	189,249,077	282,930,000	472,179,077	80,531,478	6.85%
2026	1,233,515,000	16.24%	30.94%	47.17%	47.17%	581,899,292	16.24%	200,301,384	297,875,000	498,176,384	83,722,909	6.79%
2027	1,295,129,000	16.37%	30.94%	47.30%	47.30%	612,654,426	16.37%	211,995,724	313,615,000	525,610,724	87,043,701	6.72%
2028	1,359,839,000	16.50%	30.94%	47.43%	47.43%	645,038,877	16.50%	224,361,610	330,195,000	554,556,610	90,482,267	6.65%
2029	1,428,015,000	16.63%	30.94%	47.57%	47.57%	679,240,753	16.63%	237,472,686	347,705,000	585,177,686	94,063,067	6.59%
2030	1,499,757,000	16.76%	30.94%	47.70%	47.70%	715,321,312	16.76%	251,359,273	366,170,000	617,529,273	97,792,039	6.52%

Total Employer Savings:	$1,622,843,750
PV of Employer Savings @ 5.80%:	$761,146,449
PV of Employer Savings @ 8.25%:	$586,192,755

"Board Recommended Employer Contribution Rate" as provided in 2004 Mercer TRS Report

(1) Salaries/earnings based on 2004 Mercer TRS Report, Page 28, Table 2

(2) Normal Cost Rate is an estimate based on conversation with Mercer. Needs to be validated by actuary. Does not impact potential savings from financing.

(3) 2006 Past Service Rate based on 2004 Mercer TRS Report, Page 3. After 2006, Past Service Rates assume $2.2 billion unfunded liability from 2004 Mercer TRS report is amortized over 25 years (2006-2030) at 8.25%. In addition, after 2006, in years when the Total Employer Contribution Rate exceeds the Adjusted Employer Contribution Rate, the resulting growth in the unfunded liability is amortized through 2030 at 8.25%.

(4) 2006 and 2007 Adjusted Employer Contribution Rate based on 2004 Mercer TRS Report, Page 3.

* *Please see page 10 of this presentation for important disclosure on our calculation of the numbers on this page.*

Appendix A: Detailed Savings Analysis

Pension Financing Savings Calculations*

How we built to the savings calculations on the prior two pages...

- **Columns B-F:** In the "No Action" columns, we estimate what future payments would be if no pension financing occurs and the Employer Contribution Rate increases as much as necessary for employers to pay off their 2004 unfunded liabilities over 25 years.
  - See footnotes of table for specific calculation methodologies.
  - Total Employer Contribution Rate (column D) calculated by adding Consolidated/Normal Cost Rate (Column B) and Past Service Rate (column C). However, due to 5% annual growth cap in PERS Employer Contribution Rates, Adjusted Employer Contribution Rate (column E) lower in early years, thereby growing unfunded liability.
  - Total "No Action" payments calculated by multiplying Adjusted Employer Contribution Rate by Salaries.
- **Columns G-J:** In the "Proposed Pension Bond Solution" columns, we estimate what future payments would be if employers continue to make Consolidated/Normal Cost Rate payments, but replace Past Service Rate payments (amortized at 8.25%) with pension bond debt service payments (amortized at 5.80%).
  - Total "Proposed Pension Bond Solution" payments calculated by adding Consolidated/Normal Cost Rate payments and pension bond debt service.
- **Columns K-L:** Finally, in the "Potential Savings" columns, we take the expected difference in future payments and present value these savings at both the actuarial 8.25% rate and the expected bond rate of 5.80%.

** Please see page 10 of this presentation for important disclosure on our calculation of the numbers on this page.*

Appendix A: Detailed Savings Analysis

Additional Data Points to Refine Savings Calculations*

We based our savings calculations off the 2004 Mercer Actuarial Report, but had to make some assumptions on our own. To refine our calculations, we will need more information on:

- **Current Unfunded Liability Instead of 2004 Unfunded Liability:** To calculate the past service rates, we utilized unfunded liability numbers (from the Mercer report) as of June 30, 2004, and amortized these liabilities from 2006-2030. Of course, the "current" unfunded liability will change when the next actuarial report is released.

- **Future Salaries/Earnings:** We pulled future employer salaries from Table 2 of the 2004 Mercer PERS and TRS reports (page 33 in PERS report and page 28 in TRS report).

- **Expected Future Consolidated/Normal Cost Rate:** Future consolidated/normal cost rates are based on a conversation we had with Mercer, but would need to be further validated by an actuary. That said, consolidated/normal cost rates do not impact pension bond savings calculations since they are the same for both "No Action" and "Proposed Pension Bond Solution" cases.

- **Credit of the Bonds:** We have assumed insured, A1 underlying rated bonds with a reserve fund equal to average annual debt service (funded with a surety policy).

* *Please see page 10 of this presentation for important disclosure on our calculation of the numbers on this page.*

Appendix B: Copy of House Bill No. 278

HOUSE BILL NO. 278

IN THE LEGISLATURE OF THE S .TE OF ALASKA

TWENTY-FOURTH LEGISLATURE - FIRST SESSION

BY REPRESENTATIVE HAWKER

Introduced: 4/19/05
Referred: State Affairs, Finance

A BILL

FOR AN ACT ENTITLED

"An Act relating to the Alaska Municipal Bond Bank Authority; permitting the Alaska Municipal Bond Bank Authority or a subsidiary of the authority to assist state and municipal governmental employers by issuing bonds and other commercial paper to enable the governmental employers to prepay all or a portion of the governmental employers' shares of the unfunded accrued actuarial liabilities of retirement systems and authorizing governmental employers to contract with and to issue bonds, notes, or commercial paper to the authority or its subsidiary corporation for that purpose; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

*** Section 1.** AS 44.85.010 is amended to read:

Sec. 44.85.010. Legislative policy. (a) It is the policy of the state <u>to</u>

(1) [TO] foster and promote by all reasonable means the provision of

adequate capital markets and facilities for borrowing money by municipalities in the state to finance capital improvements or for other authorized purposes, to assist these municipalities in fulfilling their capital needs and requirements by use of borrowed money within statutory interest rate or cost of borrowing limitations, to the greatest extent possible to reduce costs of borrowed money to taxpayers and residents of the state, and equally to encourage continued investor interest in the purchase of bonds or notes of municipalities as sound and preferred securities for investment;

(2) [TO] encourage municipalities to continue their independent undertakings and financing of capital improvements and other authorized purposes and to assist them by making capital funds available at reduced interest costs for orderly financing of capital improvements and other purposes especially during periods of restricted credit or money supply, particularly for those municipalities not otherwise able to borrow for capital needs;

(3) [TO] assist municipalities to provide for adequate insurance coverage by authorizing the Alaska Municipal Bond Bank Authority to issue negotiable or nonnegotiable revenue bonds, notes, or certificates of participation either directly or through an entity it may create for the purpose of providing a self-insurance program for municipalities or municipal joint insurance arrangements organized under AS 21.76;

(4) assist governmental employers to prepay all or a portion of their share of unfunded accrued actuarial liabilities of retirement systems in an effort to reduce their costs of satisfying their contractual obligations to provide retirement and other benefits to public employees through the issuance of bonds, notes, or commercial paper by the bond bank authority or by a subsidiary corporation created by the bond bank authority under AS 44.85.085.

(b) The legislature further declares that

(1) the exercise of the powers of the state in the interest of its municipalities **and in the interest of public employees of the state and of its municipalities** is required to further and implement the policies declared in (a) of this section by authorizing the creation of a state bond bank authority as a body corporate and politic that will have full powers to borrow money and to issue its bonds and notes

to make capital funds available for borrowing by municipalities **and for borrowing by or on behalf of governmental employers, by authorizing governmental employers to contract with the bond bank authority or with a subsidiary created under AS 44.85.085 for the purpose of reducing future costs of providing retirement and other benefits to employees,** and by granting broad powers to the bond bank authority to carry out the declared policies, which are in the public interest of the state and its taxpayers and residents:

(2) state funds should be applied or authorized to be paid to a state bond bank authority only to provide adequate assurance and security to the holders of the bonds or notes of the bond bank authority;

(3) the bond bank authority should conduct its operations to provide the lowest rates in terms of borrowing to municipalities **and to governmental employers** as is consistent with a self-supporting operation with no expectation of subsidization with state funds; the legislature does not intend that the bond bank authority be utilized as a means to finance municipalities **or governmental employers** beyond their capability to meet repayment schedules and debt service requirements of bonds**, notes, commercial paper, or contractual obligations to the bond bank authority** [OR NOTES].

*** Sec. 2.** AS 44.85.080 is amended to read:

Sec. 44.85.080. Powers of bond bank authority. The bond bank authority may

(1) sue and be sued;

(2) adopt and alter an official seal;

(3) make and enforce bylaws and regulations for the conduct of its business and for the use of its services and facilities;

(4) maintain an office at any place in the state;

(5) acquire, hold, use, and dispose of its income, revenues, funds, and money;

(6) acquire, rent, lease, hold, use, and dispose of other personal property for its purposes;

(7) subject to AS 44.85.100(b), borrow money and issue its negotiable

bonds or notes and provide for and secure their payment, provide for the rights of their holders and purchase, hold and dispose of any of its bonds or notes;

(8) fix and revise from time to time and charge and collect fees and charges for the use of its services or facilities;

(9) accept gifts or grants from the United States, or from any governmental unit or person, firm, or corporation, carry out the terms or provisions or make agreements with respect to the gifts or grants, and do all things necessary, useful, desirable, or convenient in connection with procuring, accepting, or disposing of the gifts or grants;

(10) do anything authorized by this chapter, through its officers, agents, or employees or by contracts with a person;

(11) make, enter into, and enforce all contracts necessary, convenient, or desirable for the purposes of the bond bank authority or pertaining to a loan to a political subdivision, a purchase or sale of municipal bonds or other investments, or the performance of its duties and execution of any of its powers under this chapter;

(12) purchase or hold municipal bonds at prices and in a manner the bond bank authority considers advisable, and sell municipal bonds acquired or held by it at prices without relation to cost and in a manner the bond bank authority considers advisable;

(13) invest funds or money of the bond bank authority not required at the time of investment for loan to political subdivisions for the purchase of municipal bonds, in the same manner as permitted for investment of funds belonging to the state, except as otherwise provided in this chapter;

(14) prescribe the form of application or procedure required of a political subdivision for a loan or purchase of its municipal bonds, fix the terms and conditions of the loan or purchase, and enter into agreements with political subdivisions with respect to loans or purchases;

(15) render services to a political subdivision in connection with a public or private sale of its municipal bonds, including advisory and other services, and charge for services rendered;

(16) charge for its costs and services in review or consideration of a

proposed loan to a political subdivision or purchase by the bond bank authority of municipal bonds of the political subdivision, whether or not the loan is made or the municipal bonds purchased;

(17) fix and establish terms and provisions with respect to a purchase of municipal bonds by the bond bank authority, including date and maturities of the bonds, provisions as to redemption or payment before maturity, and any other matters which in connection with the purchase are necessary, desirable, or advisable in the judgment of the bond bank authority;

(18) procure insurance against any losses in connection with its property, operations, or assets in amounts and from insurers as it considers desirable;

(19) to the extent permitted under its contracts with the holders of bonds or notes of the bond bank authority, consent to modification of the rate of interest, time and payment of installment of principal or interest, security or any other term of a bond or note, contract or agreement of any kind to which the bond bank authority is a party;

(20) by regulation, create a new entity **or new entities** for the purpose of issuing negotiable or nonnegotiable revenue bonds, notes, or certificates of participation to finance a self-insurance program for municipalities or municipal joint insurance arrangements organized under AS 21.76 **or to provide assistance to governmental employers under AS 44.85.085(a)**; the powers, duties, and membership of the new entity **or entities** shall be limited to the powers, duties, and membership of the authority and stated in the regulation; the new entity **or entities** shall **each** be a public corporation and an instrumentality of the state with the same legal existence and continuing succession as the bond bank authority; and

(21) do all acts and things necessary, convenient, or desirable to carry out the powers expressly granted or necessarily implied in this chapter.

*** Sec. 3.** AS 44.85 is amended by adding new sections to read:

Sec. 44.85.085. Creation of subsidiary corporation. (a) The bond bank authority may create one or more subsidiary corporations for the following purposes:

(1) providing financial and other assistance to governmental employers to enable the governmental employers to reduce their costs of providing retirement

and other benefits to their employees by prepaying all or a portion of their shares of the unfunded accrued actuarial liabilities of retirement systems;

(2) receiving payments and providing servicing for payments to or from participating governmental employers; and

(3) performing other duties and providing other services as the subsidiary corporation considers necessary or desirable to further the purposes set out in (1) and (2) of this subsection.

(b) The bond bank authority may incorporate under AS 10.20.146 - 10.20.166 a subsidiary corporation created under (a) of this section. The bond bank authority may transfer assets of the bond bank authority to the subsidiary corporation and may agree to secure bonds, notes, commercial paper, or other obligations of the subsidiary corporation with a reserve fund established under AS 44.85.270.

(c) A subsidiary corporation created under (a) of this section may borrow money and issue bonds, notes, commercial paper, or other obligations as evidence of that borrowing and may have all the powers of the bond bank authority that the bond bank authority grants to it. The provisions of AS 44.85.130 - 44.85.170 and 44.85.270 - 44.85.390 apply to the subsidiary corporation and to bonds, notes, commercial paper, or other obligations issued by the subsidiary corporation. Unless otherwise provided by the bond bank authority, the debts, liabilities, and obligations of the subsidiary corporation are not the debts, liabilities, or obligations of the bond bank authority.

(d) The staff of the bond bank authority serves as staff of a subsidiary corporation created under (a) of this section. The bond bank authority shall determine the membership or the process for selecting the membership of the board of directors of the subsidiary corporation. The bond bank authority may permit some or all of its directors to serve on the board of directors of the subsidiary corporation.

Sec. 44.85.086. Powers of subsidiary corporation. A subsidiary corporation created under AS 44.85.085 has the following powers in addition those granted to it under AS 44.85.085(c):

(1) to make loans to and enter into contracts with governmental employers;

(2) to incur debt in furtherance of its purposes in the form of bonds,

notes, commercial paper, or other forms as the subsidiary corporation considers appropriate;

(3) to secure its debt with a pledge of any assets that are available to the subsidiary corporation for the purpose, including identified revenue and contractual payments from participating governmental employers, and the general assets and revenue of the subsidiary corporation; and

(4) to enter into contracts with underwriters, bond counsel, financial advisors, accountants, actuaries, and other contractors to provide assistance as the subsidiary corporation considers desirable to accomplish its purposes.

* **Sec. 4.** AS 44.85.100(b) is amended to read:

(b) The bond bank authority shall include in the report required by (a) of this section an estimate of the amount of revenue bonds of the bond bank authority to be issued during the fiscal year following the fiscal year in which the report is submitted. **Other than refunding bonds and other than bonds, notes, commercial paper, or other obligations issued under AS 44.85.086 and 44.85.180(a)(5), the** [THE] bond bank authority may not issue revenue bonds [, OTHER THAN REFUNDING BONDS,] in excess of $75,000,000 during any fiscal year beginning after June 30, 1981, unless the legislature, by law, approves the estimate required by this subsection for that fiscal year.

* **Sec. 5.** AS 44.85.180(a) is amended to read:

(a) Subject to AS 44.85.100(b), the bond bank authority may issue its bonds or notes in principal amounts that it considers necessary to provide funds for any purposes under this chapter, including

(1) the purchase of municipal bonds;

(2) the making of loans through the purchase of municipal bonds, notes, or certificates of participation secured by an agreement between the bond bank authority and a municipality or a municipal joint insurance arrangement organized under AS 21.76;

(3) the payment, funding, or refunding of the principal of, or interest or redemption premiums on, bonds or notes issued by it whether the bonds or notes or interest to be funded or refunded have or have not become due;

(4) the establishment or increase of reserves to secure or to pay bonds or notes or interest on bonds or notes and all other costs or expenses of the bond bank authority incident to and necessary or convenient to carry out its corporate purposes and powers;

(5) assisting governmental employers to prepay all or a portion of their share of the unfunded accrued actuarial liabilities of retirement systems, with security as the bond bank authority considers reasonable.

*** Sec. 6.** AS 44.85.180(c) is amended to read:

(c) Notwithstanding the provisions of (a) and (b) of this section, the total amount of bond bank authority bonds and notes outstanding at any one time [, EXCEPT BONDS OR NOTES ISSUED TO FUND OR REFUND BONDS OR NOTES,] may not exceed $500,000,000. **This subsection does not apply to (1) bonds or notes issued to fund or refund bonds or notes; (2) bonds, notes, commercial paper, and other obligations issued under AS 44.85.086 or 44.85.180(a)(5).**

*** Sec. 7.** AS 44.85.410(a)(5) is amended by adding a new paragraph to read:

(8) "governmental employer" means the State of Alaska or a municipality or other state or municipal governmental entity within the state, including an agency, instrumentality, district, school district, public corporation, department, division, or other subdivision of the state or of a municipality, in its capacity as an employer.

*** Sec. 8.** This act takes effect immediately under AS 01.10.070(c).

Disclaimers

Merrill Lynch prohibits (a) employees from, directly or indirectly, offering a favorable research rating or specific price target, or offering to change such rating or price target, as consideration or inducement for the receipt of business or for compensation, and (b) Research Analysts from being compensated for involvement in investment banking transactions except to the extent that such participation is intended to benefit investor clients.

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Ian Laing

From: Brad Fluetsch [bjf@gci.net]
Sent: Tuesday, January 17, 2006 8:28 AM
To: Rep. Paul Seaton
Subject: Pension Bonds
Attachments: Bradley J Fluetsch (bjf@gci.net).vcf

Lets say you issue a 20 year bond, and then lets say time goes by. In fact lets us say 15 years.

Is it prudent to have a 60/40 asset allocation when you know that money is leaving in 5 years, or 4, 3, 2, 1? What happens if 2001 is twenty years from now?

Bradley J Fluetsch, CFA
Fluetsch Financial Services, LLC

Ian Laing

From: Brad Fluetsch [bjf@gci.net]
Sent: Tuesday, January 17, 2006 7:30 AM
To: Rep. Paul Seaton
Subject: Pension Bonds
Attachments: Bradley J Fluetsch (bjf@gci.net).vcf

I have been thinking about the pension bond issue and this is something I would make those professionals do for you as Chairman.

E(r) is the expected return 8.25% with an expected standard deviation of 16%. To achieve that, a 60% stock, 40% bond portfolio is used.

Add pension bonds to the equation where the proceeds are invested 100% into the stock market having no defense to your question why would I put proceeds into the bond market and guarantee a loss.

Now remodel the portfolio to earn 8.25%? You will be surprised at the answers.

Don't re-balance the portfolio and your expected return goes up to over 10% with a standard deviation ballooning well over 20%. A pension bond in the portfolio mix acts as a bond allocation reducer to the extent the cash flows and interest rates are comparable. Add a pension bond subtract Lehman Aggregate exposure. Investment the proceeds into the equity market, is going all in, in Texas Hold-em with a pair of 8's.

One other thought. I just wonder about the decision makers in Alaska. It was bad decisions by the pension board that has us in this mess and look at who made the board up? I think there is a law against giving loading pistols to children to play with.

Bradley J Fluetsch, CFA
Fluetsch Financial Services, LLC

HOUSE BILL NO. 278

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-FOURTH LEGISLATURE - FIRST SESSION

BY REPRESENTATIVE HAWKER

Introduced: 4/19/05
Referred: State Affairs, Finance

A BILL

FOR AN ACT ENTITLED

"An Act relating to the Alaska Municipal Bond Bank Authority; permitting the Alaska Municipal Bond Bank Authority or a subsidiary of the authority to assist state and municipal governmental employers by issuing bonds and other commercial paper to enable the governmental employers to prepay all or a portion of the governmental employers' shares of the unfunded accrued actuarial liabilities of retirement systems and authorizing governmental employers to contract with and to issue bonds, notes, or commercial paper to the authority or its subsidiary corporation for that purpose; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

*** Section 1.** AS 44.85.010 is amended to read:

Sec. 44.85.010. Legislative policy. (a) It is the policy of the state **to**

(1) [TO] foster and promote by all reasonable means the provision of

New Text Underlined [DELETED TEXT BRACKETED]

adequate capital markets and facilities for borrowing money by municipalities in the state to finance capital improvements or for other authorized purposes, to assist these municipalities in fulfilling their capital needs and requirements by use of borrowed money within statutory interest rate or cost of borrowing limitations, to the greatest extent possible to reduce costs of borrowed money to taxpayers and residents of the state, and equally to encourage continued investor interest in the purchase of bonds or notes of municipalities as sound and preferred securities for investment;

(2) [TO] encourage municipalities to continue their independent undertakings and financing of capital improvements and other authorized purposes and to assist them by making capital funds available at reduced interest costs for orderly financing of capital improvements and other purposes especially during periods of restricted credit or money supply, particularly for those municipalities not otherwise able to borrow for capital needs;

(3) [TO] assist municipalities to provide for adequate insurance coverage by authorizing the Alaska Municipal Bond Bank Authority to issue negotiable or nonnegotiable revenue bonds, notes, or certificates of participation either directly or through an entity it may create for the purpose of providing a self-insurance program for municipalities or municipal joint insurance arrangements organized under AS 21.76;

(4) assist governmental employers to prepay all or a portion of their share of unfunded accrued actuarial liabilities of retirement systems in an effort to reduce their costs of satisfying their contractual obligations to provide retirement and other benefits to public employees through the issuance of bonds, notes, or commercial paper by the bond bank authority or by a subsidiary corporation created by the bond bank authority under AS 44.85.085.

(b) The legislature further declares that

(1) the exercise of the powers of the state in the interest of its municipalities **and in the interest of public employees of the state and of its municipalities** is required to further and implement the policies declared in (a) of this section by authorizing the creation of a state bond bank authority as a body corporate and politic that will have full powers to borrow money and to issue its bonds and notes

to make capital funds available for borrowing by municipalities **and for borrowing by or on behalf of governmental employers, by authorizing governmental employers to contract with the bond bank authority or with a subsidiary created under AS 44.85.085 for the purpose of reducing future costs of providing retirement and other benefits to employees,** and by granting broad powers to the bond bank authority to carry out the declared policies, which are in the public interest of the state and its taxpayers and residents;

(2) state funds should be applied or authorized to be paid to a state bond bank authority only to provide adequate assurance and security to the holders of the bonds or notes of the bond bank authority;

(3) the bond bank authority should conduct its operations to provide the lowest rates in terms of borrowing to municipalities **and to governmental employers** as is consistent with a self-supporting operation with no expectation of subsidization with state funds; the legislature does not intend that the bond bank authority be utilized as a means to finance municipalities **or governmental employers** beyond their capability to meet repayment schedules and debt service requirements of bonds**, notes, commercial paper, or contractual obligations to the bond bank authority** [OR NOTES].

*** Sec. 2.** AS 44.85.080 is amended to read:

Sec. 44.85.080. Powers of bond bank authority. The bond bank authority may

(1) sue and be sued;

(2) adopt and alter an official seal;

(3) make and enforce bylaws and regulations for the conduct of its business and for the use of its services and facilities;

(4) maintain an office at any place in the state;

(5) acquire, hold, use, and dispose of its income, revenues, funds, and money;

(6) acquire, rent, lease, hold, use, and dispose of other personal property for its purposes;

(7) subject to AS 44.85.100(b), borrow money and issue its negotiable

bonds or notes and provide for and secure their payment, provide for the rights of their holders and purchase, hold and dispose of any of its bonds or notes;

(8) fix and revise from time to time and charge and collect fees and charges for the use of its services or facilities;

(9) accept gifts or grants from the United States, or from any governmental unit or person, firm, or corporation, carry out the terms or provisions or make agreements with respect to the gifts or grants, and do all things necessary, useful, desirable, or convenient in connection with procuring, accepting, or disposing of the gifts or grants;

(10) do anything authorized by this chapter, through its officers, agents, or employees or by contracts with a person;

(11) make, enter into, and enforce all contracts necessary, convenient, or desirable for the purposes of the bond bank authority or pertaining to a loan to a political subdivision, a purchase or sale of municipal bonds or other investments, or the performance of its duties and execution of any of its powers under this chapter;

(12) purchase or hold municipal bonds at prices and in a manner the bond bank authority considers advisable, and sell municipal bonds acquired or held by it at prices without relation to cost and in a manner the bond bank authority considers advisable;

(13) invest funds or money of the bond bank authority not required at the time of investment for loan to political subdivisions for the purchase of municipal bonds, in the same manner as permitted for investment of funds belonging to the state, except as otherwise provided in this chapter;

(14) prescribe the form of application or procedure required of a political subdivision for a loan or purchase of its municipal bonds, fix the terms and conditions of the loan or purchase, and enter into agreements with political subdivisions with respect to loans or purchases;

(15) render services to a political subdivision in connection with a public or private sale of its municipal bonds, including advisory and other services, and charge for services rendered;

(16) charge for its costs and services in review or consideration of a

proposed loan to a political subdivision or purchase by the bond bank authority of municipal bonds of the political subdivision, whether or not the loan is made or the municipal bonds purchased;

(17) fix and establish terms and provisions with respect to a purchase of municipal bonds by the bond bank authority, including date and maturities of the bonds, provisions as to redemption or payment before maturity, and any other matters which in connection with the purchase are necessary, desirable, or advisable in the judgment of the bond bank authority;

(18) procure insurance against any losses in connection with its property, operations, or assets in amounts and from insurers as it considers desirable;

(19) to the extent permitted under its contracts with the holders of bonds or notes of the bond bank authority, consent to modification of the rate of interest, time and payment of installment of principal or interest, security or any other term of a bond or note, contract or agreement of any kind to which the bond bank authority is a party;

(20) by regulation, create a new entity **or new entities** for the purpose of issuing negotiable or nonnegotiable revenue bonds, notes, or certificates of participation to finance a self-insurance program for municipalities or municipal joint insurance arrangements organized under AS 21.76 **or to provide assistance to governmental employers under AS 44.85.085(a)**; the powers, duties, and membership of the new entity **or entities** shall be limited to the powers, duties, and membership of the authority and stated in the regulation; the new entity **or entities** shall **each** be a public corporation and an instrumentality of the state with the same legal existence and continuing succession as the bond bank authority; and

(21) do all acts and things necessary, convenient, or desirable to carry out the powers expressly granted or necessarily implied in this chapter.

* **Sec. 3.** AS 44.85 is amended by adding new sections to read:

Sec. 44.85.085. Creation of subsidiary corporation. (a) The bond bank authority may create one or more subsidiary corporations for the following purposes:

(1) providing financial and other assistance to governmental employers to enable the governmental employers to reduce their costs of providing retirement

and other benefits to their employees by prepaying all or a portion of their shares of the unfunded accrued actuarial liabilities of retirement systems;

(2) receiving payments and providing servicing for payments to or from participating governmental employers: and

(3) performing other duties and providing other services as the subsidiary corporation considers necessary or desirable to further the purposes set out in (1) and (2) of this subsection.

(b) The bond bank authority may incorporate under AS 10.20.146 - 10.20.166 a subsidiary corporation created under (a) of this section. The bond bank authority may transfer assets of the bond bank authority to the subsidiary corporation and may agree to secure bonds, notes, commercial paper, or other obligations of the subsidiary corporation with a reserve fund established under AS 44.85.270.

(c) A subsidiary corporation created under (a) of this section may borrow money and issue bonds, notes, commercial paper, or other obligations as evidence of that borrowing and may have all the powers of the bond bank authority that the bond bank authority grants to it. The provisions of AS 44.85.130 - 44.85.170 and 44.85.270 - 44.85.390 apply to the subsidiary corporation and to bonds, notes, commercial paper, or other obligations issued by the subsidiary corporation. Unless otherwise provided by the bond bank authority, the debts, liabilities, and obligations of the subsidiary corporation are not the debts, liabilities, or obligations of the bond bank authority.

(d) The staff of the bond bank authority serves as staff of a subsidiary corporation created under (a) of this section. The bond bank authority shall determine the membership or the process for selecting the membership of the board of directors of the subsidiary corporation. The bond bank authority may permit some or all of its directors to serve on the board of directors of the subsidiary corporation.

Sec. 44.85.086. Powers of subsidiary corporation. A subsidiary corporation created under AS 44.85.085 has the following powers in addition those granted to it under AS 44.85.085(c):

(1) to make loans to and enter into contracts with governmental employers;

(2) to incur debt in furtherance of its purposes in the form of bonds,

notes, commercial paper, or other forms as the subsidiary corporation considers appropriate;

(3) to secure its debt with a pledge of any assets that are available to the subsidiary corporation for the purpose, including identified revenue and contractual payments from participating governmental employers, and the general assets and revenue of the subsidiary corporation; and

(4) to enter into contracts with underwriters, bond counsel, financial advisors, accountants, actuaries, and other contractors to provide assistance as the subsidiary corporation considers desirable to accomplish its purposes.

* **Sec. 4.** AS 44.85.100(b) is amended to read:

(b) The bond bank authority shall include in the report required by (a) of this section an estimate of the amount of revenue bonds of the bond bank authority to be issued during the fiscal year following the fiscal year in which the report is submitted. **Other than refunding bonds and other than bonds, notes, commercial paper, or other obligations issued under AS 44.85.086 and 44.85.180(a)(5), the** [THE] bond bank authority may not issue revenue bonds [, OTHER THAN REFUNDING BONDS,] in excess of $75,000,000 during any fiscal year beginning after June 30, 1981, unless the legislature, by law, approves the estimate required by this subsection for that fiscal year.

* **Sec. 5.** AS 44.85.180(a) is amended to read:

(a) Subject to AS 44.85.100(b), the bond bank authority may issue its bonds or notes in principal amounts that it considers necessary to provide funds for any purposes under this chapter, including

(1) the purchase of municipal bonds,

(2) the making of loans through the purchase of municipal bonds, notes, or certificates of participation secured by an agreement between the bond bank authority and a municipality or a municipal joint insurance arrangement organized under AS 21.76;

(3) the payment, funding, or refunding of the principal of, or interest or redemption premiums on, bonds or notes issued by it whether the bonds or notes or interest to be funded or refunded have or have not become due;

(4) the establishment or increase of reserves to secure or to pay bonds or notes or interest on bonds or notes and all other costs or expenses of the bond bank authority incident to and necessary or convenient to carry out its corporate purposes and powers;

(5) assisting governmental employers to prepay all or a portion of their share of the unfunded accrued actuarial liabilities of retirement systems, with security as the bond bank authority considers reasonable.

* **Sec. 6.** AS 44.85.180(c) is amended to read:

(c) Notwithstanding the provisions of (a) and (b) of this section, the total amount of bond bank authority bonds and notes outstanding at any one time [, EXCEPT BONDS OR NOTES ISSUED TO FUND OR REFUND BONDS OR NOTES,] may not exceed $500,000,000. **This subsection does not apply to (1) bonds or notes issued to fund or refund bonds or notes; (2) bonds, notes, commercial paper, and other obligations issued under AS 44.85.086 or 44.85.180(a)(5).**

No debt limit

* **Sec. 7.** AS 44.85.410(a)(5) is amended by adding a new paragraph to read:

(8) "governmental employer" means the State of Alaska or a municipality or other state or municipal governmental entity within the state, including an agency, instrumentality, district, school district, public corporation, department, division, or other subdivision of the state or of a municipality, in its capacity as an employer.

* **Sec. 8.** This act takes effect immediately under AS 01.10.070(c).

Nothing in the bill exempts political subdivisions from constitutional vote requirement of Jan 5, 06 legal opinion from leg legal – Tam Cook & Ray Weyhrauch "ratified by a majority vote of those qualified & voting and voting on the question"

An Introduction to

Pension Obligation Bonds

ROGER L. DAVIS

ORRICK

ABOUT THE AUTHOR

Roger L. Davis is chair of the Public Finance Department at Orrick, Herrington & Sutcliffe LLP, the premier bond counsel firm in the country. Mr. Davis is also head of Orrick's Pension Obligation Bond Group and has worked on more than 20 POB issues in various states.

Members of Orrick's **Pension Obligation Bond Group** are shown on the contact list on the inside of the back cover of this booklet.

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CHAPTER ONE

Introduction

Pension obligation bonds ("POBs") are bonds issued by a state or local government to pay its obligation to the pension fund or system in which its employees (or others for whose pension benefits it is responsible) are members. POBs are an increasingly popular way for state or local governments to accomplish a variety of financial and other (including political) objectives.

According to Thomson Financial, during the past decade there have been at least 275 POB issues by state and local government issuers in at least 22 states.

The purpose of this pamphlet is to introduce interested parties to the reasons why POBs are issued, advantages/disadvantages, structure alternatives, federal tax issues, and representative programs in three states where POBs are particularly popular.

The author is chair of the Public Finance Department at Orrick, Herrington & Sutcliffe LLP and has been bond counsel on more than twenty POBs in various states. Orrick is the nation's premier bond counsel firm, ranked number one for more than a decade,[1] with extensive experience in all types of POB and similar financings.[2]

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[1] Rankings for securities transactions of various types are performed annually by Thomson Financial, which has ranked Orrick number one in the country as bond counsel since prior to 1990. In an average year, Orrick handles more than 300 bond issues, aggregating more than $20 billion.

[2] Orrick is ranked by Thomson Financial as the number one bond counsel in the country for POBs over the last decade, with more than 4 times as many such issues as the second ranked firm.

CHAPTER TWO

Pension Obligations

Pension obligations generally fall into two categories:

A. Unfunded Accrued Actuarial Liability (UAAL)

The unfunded accrued actuarial liability ("UAAL") is determined by the actuary for the pension fund to be the amount by which the pension fund is short of the amount that will be necessary, without further payments from the state or local government, to pay benefits already earned by current and former employees covered by the pension system. The UAAL is based on assumptions (in some cases established by the actuary and in some cases by the pension system or by the state or local government) as to retirement age, mortality, projected salary increases attributed to inflation, across-the-board raises and merit raises, increases in retirement benefits, cost-of-living adjustments, valuation of current assets, investment return and other matters. In order to avoid volatility in the UAAL based on swings in market valuation, the investment gains and losses on assets in the pension fund are often recognized (sometimes referred to as "smoothed") over a 3 to 5 year period.[1] The state or local government is obligated to amortize the UAAL over a period established by law or agreement with the pension system, typically at an assigned interest rate established by the pension system, which assigned interest rate is usually the same as the actuary's assumed rate of investment return on pension fund assets (sometimes referred to as the "Actuarial Rate").

[1] Note that the smoothing methodology referred to may result in "unrealized" or "lagging" unfunded liability. See discussion of POB possibilities in footnote 4.

B. Normal annual contribution

In addition to making payments toward any UAAL, the state or local government is required to make payments to the pension fund each year in respect of the present value of the benefits being earned by the current employees covered by the pension fund (that is, the amount being earned by those employees with each paycheck necessary to pay future retirement benefits, based on assumptions of mortality rates, salary increases, assumed rate of investment income and the other assumptions referred to in the preceding paragraph), generally referred to as the "normal annual contribution."

CHAPTER THREE

Reasons For Issuing POBs

The reasons why state or local governments issue POBs vary from issuer to issuer and from time to time with economic conditions and other circumstances. However, these reasons generally fall into one or more of the following categories:

A. Interest Rate Savings

As described in Chapter Two, most pension systems assign an interest component to the payments the state or local government is required to make in respect of its UAAL. Assigned interest rates currently generally range from 7½% to 8½% depending on the particular pension system. When taxable bond rates are low, and as of fall 2003 they are roughly 5.95% or less for 30 year debt, then POBs can function like a classic interest rate savings refunding. For example, if the assigned rate is 7.5% on a UAAL of $100,000,000, the annual all in cost would be roughly $8,500,000 assuming a 30 year amortization, compared to an all in cost of $7,300,000 on POBs amortized over the same period assuming a 5.95% interest rate and costs of issuance of 1%. These savings to a degree can be front loaded or otherwise structured to occur when most needed (see Section C of Chapter 5).

On the other hand, because the factors on which the UAAL is based are constantly changing (such as mortality and investment return), the final amount of interest rate savings cannot be determined with certainty. Also, the assigned interest rate may change from time to time during the life of the bond issue, and, at least theoretically, the amount of interest rate savings could become negative (even if all the other factors remain the same) if the assigned interest rate were to drop and remain below

the bond interest rate for a substantial period. So far this has not occurred, even though the assigned interest rate in some cases has dropped by more than one percentage point since the mid-1990s. This possibility is furthermore generally considered to be unlikely, because the assigned interest rate is based on an assumed investment rate of return which reflects investments with a higher risk profile and, therefore, higher projected return than the POBs.

B. Discounts

In some cases, it may also be possible to negotiate discounts with the pension system for early payment of the normal annual contribution or even the UAAL (which may reflect the pension fund's assumed rate of investment return or even its then current investment opportunity). It may also be an opportunity to renegotiate other terms of the pension obligation.

C. Arbitrage

Generally, pension funds may invest in a much broader range of investments than the state or local governments, and the size and diversity of the pension fund's portfolio allows for a higher risk profile than the state or local government could prudently sustain with its own investments. As mentioned above, this is why the assumed rate of investment return is generally materially higher than the bond rate. The actual investment performance of most pension systems (at least in most years) has substantially exceeded the assumed interest rate. Therefore, there is the possibility that proceeds of the POBs will be invested by the pension fund at significantly higher return than the interest cost on the POBs (even if interest on the POBs is taxable).

In almost all cases, the benefit of earnings on investment of bond proceeds in the pension fund will be credited to the state or local government issuer either in reduced UAAL or reduced normal annual contribution or both. In some cases, the allocation of this benefit is subject to negotiation between the state or local government and the pension system and may even be decided by the state or local government each year. This benefit from earnings is why interest on POBs is generally not exempt from federal income tax (see Chapter 6). So this arbitrage is not the typical municipal bond arbitrage derived from borrowing at tax-exempt rates and investing at taxable rates, but rather what might be called risk arbitrage derived from borrowing against the credit of the state or local government and participating through the pension fund in a portfolio of investments that is designed to produce a higher yield and manage the higher risk through diversification. Of course, there is no guaranty that such arbitrage will be positive.

D. Budget Relief

Particularly in the current environment of substantial budget deficits, POBs are being used for budget relief. This may be accomplished by:

(1) reamortizing the UAAL by replacing the obligation to the pension fund with POBs having a longer term and/or lower payments in the early years (or even no debt service in the early years if capital appreciation bonds (CABs) or capitalized interest is used); and/or

(2) funding the normal annual contribution for the current (and maybe the next) fiscal year (to the extent permitted by applicable state law).

E. Labor Relations Benefits

Some state or local governments have used POBs, at least in part, to improve relations (or negotiations) with its employees and their unions by funding unfunded pension liability to those employees.

F. Better Than The Alternatives

In some cases, POBs are simply better than the alternatives: (i) paying more into the pension fund, (ii) asking employees to pay more into the pension fund; (iii) reducing benefits; or (iv) hoping that gains on pension fund investments will substantially exceed the assumed rate of investment return.

CHAPTER FOUR

Possible Disadvantages of POBs

Despite the foregoing benefits of POBs, there are a few possible disadvantages:

A. In some jurisdictions, a state or local government may negotiate or even unilaterally make changes in its pension obligation, perhaps by postponing payments or changing assumptions. POBs replace this potentially flexible pension obligation with a more immutable bond obligation.

B. As explained in Chapter 3, while unlikely, it is possible that the assigned interest rate will drop below the bond interest rate or that the pension fund will have negative earnings, in each case for a sustained period.

C. If the pension fund enjoys higher than expected earnings, the pension fund may become overfunded and result in temporary contribution holidays, but also can lead to increases in retirement benefits that may be costly to sustain at some point in the future.

D. POBs result in payment to and investment by the pension fund of a lump sum amount that otherwise would have been paid and invested in increments over a period of years, concentrating rather than spreading market timing risks.

E. Almost all POBs are taxable and most taxable bonds with fixed interest rates are sold as noncallable bonds. Adding a redemption feature will ordinarily result in a materially higher interest rate cost than the same redemption feature in tax-exempt bonds. Therefore, taxable noncallable bonds may be expensive to refund or defease, although there have been a number of successful tender offer refundings of taxable POBs (that is, a tender offer was made for the prior bonds and the tender price was paid with proceeds of new refunding bonds).

Another way to address this concern is by using variable rate bonds, which may contain redemption provisions without additional interest rate cost, and may be accompanied by a floating-to-fixed interest rate swap if a fixed rate obligation is desired.

Note that many of these issues can be addressed in whole or in part by using POBs to fund less than all of the UAAL.

CHAPTER FIVE

Types of POBs

A. Security

Most POBs are payable from the general fund of the issuing state or local government. As such, they must either satisfy or be exempt from the debt limitation provisions typically found in the applicable state constitution and, accordingly, generally fall into one of the following three categories:

1. ***General obligation bonds,*** which term generally refers to bonds that satisfy any constitutional debt limitation and are backed by the full faith and credit and taxing power of the issuing state or local government. An example is the $10,000,000,000 State of Illinois General Obligation Bonds Pension Funding Series of June 2003 (Taxable), the largest POB issue to date. A variation is full faith and credit limited tax bonds payable from available general funds but without any obligation to levy additional taxes. See discussion in Chapter 10.

2. ***Obligations imposed by law,*** which term refers to an exception recognized in a few states from the otherwise applicable debt limitation contained in the state constitution. It applies to obligations imposed on the state or local government by the constitution or by statute or, in some cases, by court judgment as distinguished from a voluntary exercise of the borrowing power by the state or local government. Most pension obligations would qualify and, in states in which the obligations imposed by law concept applies, bonds issued to fund those pension obligations (POBs) are considered to have the same legal character as the pension

obligations themselves. POBs issued in California during the past decade have all been obligations imposed by law. See discussion in Chapter 9.

POBs issued as obligations imposed by law generally cannot include reserves or capitalized interest because those components of the obligation are not considered to be imposed by law; even on the theory they are essential to marketing the bonds (because so many obligations imposed by law POBs have been issued without them). On the other hand, costs of issuance may be included. The inability to include capitalized interest means that it may be difficult to achieve complete budget relief in the early period following issuance of the bonds without resort to capital appreciation bonds (CABs).

3. ***Annual appropriation bonds,*** which term refers to bonds that are not considered debt subject to a constitutional debt limitation because the state or local government issuer has no legal obligation to pay them and payment is therefore subject to annual (or other periodic) appropriation of funds for that purpose at the discretion of the legislature or governing body of the state or local government issuer. Examples include the $773.5 million POBs issued in 1996 for the State of New York and the $2.8 billion POBs issued in 1997 for the State of New Jersey.

4. ***Other.*** In the mid-1980s and occasionally since, some cities and counties in California issued POBs as so called asset-strip lease revenue bonds or certificates of participation (COPs). The city or county leased existing facilities (with a value at least equivalent to the amount of bonds/COPs to be issued) to a joint powers authority or other governmental entity or to a nonprofit corporation, simultaneously leasing them back, the leaseback was assigned to a trustee and bonds/COPs were issued secured by the leaseback payable from the city or county's general fund, and the proceeds of the bonds/COPs were paid to the pension fund net of costs of issuance and reserves and capitalized interest retained by the trustee.

In certain circumstances, it may also make sense to use revenue bonds as POBs (for example, if the issuer is a revenue producing enterprise, authority or district). (See also Chapter 10.)

B. Credit Ratings/Borrowing Capacity

Because POBs replace existing pension obligations, they are not generally viewed as adding to the debt burden of the state or local government issuer (much like a conventional refunding).[1] To quote the rating agencies:

"Moody's believes the issuance of pension obligation bonds (POBs) is one effective way of addressing an unfunded liability. Since POBs reduce the cost of funding an unfunded liability, their issuance is not by itself a credit weakness. However, the planning and analysis conducted by a local government as part of the decision to grant expanded benefits, the government's plan for funding any unfunded pension liability, and its ability and willingness to budget appropriately for any attendant higher costs, are reflective of the quality of the government's overall financial management. These factors, therefore, will be considered in our assessment of a government's general credit quality."

"Standard & Poor's factors the effects of a pension obligation bond strategy into the long-term rating of the sponsor. Standard & Poor's has viewed POBs as a strategy for savings on carrying charges as long as the transaction was structured conservatively and the assumptions were reasonable and attainable. This requires a clear financing plan including reasonable assumptions and manageable leverage. Prudent expectations for investment returns and the cautious use of resultant savings help insure a POB's success. Another positive factor for a POB is, of course, to be fortunate enough to sell the bonds in a low interest rate environment, thereby increasing the spread between interest costs and investment return expectations and lowering the risk of underperformance."

"Fitch believes that POBs, if used moderately and in conjunction with a prudent approach to investing the proceeds and other pension assets, can be a useful tool in asset liability management. However, a failure to follow balanced and prudent investment practices with respect to POB proceeds could expose the sponsor to market losses.

[1] Note that to the extent the POBs fund the normal annual contribution, new long-term debt is created which could have an affect on credit ratings not present if the POBs fund only the UAAL.

> Because a sponsor's unfunded pension liability is already factored into the rating, the issuance of POBs simply moves the obligation from one part of the balance sheet to another. However, Fitch notes that POBs create a true debt, one which must be paid on time and in full, rather than a softer pension liability that can be deferred or rescheduled from time to time during periods of fiscal stress. Consequently, POBs can have a significant effect on financial flexibility over time."

The actual ratings on the POBs will depend primarily on legal structure. General obligation bonds and annual appropriation POBs should be rated the same as the issuer's other general obligation or annual appropriation debt. Obligations imposed by law POBs are generally rated in between: a notch below the issuer's general obligation bond rating and a notch above its lease or other annual appropriation debt.

C. Structures

Because POBs are generally payable directly from the general fund of the state or local governmental issuer, the structure of the bond issue is usually simple and straightforward, varying primarily in interest rate mode, using one or a combination of the following:

1. ***Fixed rate bonds.*** Because most POBs are issued, at least in part, to achieve interest rate savings, most POBs are issued as fixed rate bonds. The advantages are the same as fixed rate bonds generally; namely, they lock in interest cost, and with interest rates at historic lows, this is a very attractive prospect in itself. The disadvantages are: (i) the assigned interest rate on the pension obligations funded with POBs is not fixed, so interest savings cannot be fixed with certainty (see Section A of Chapter 3); and (ii) fixed rate taxable bonds are usually sold as noncallable, so they cannot be easily refunded or defeased if rates drop or circumstances change (see discussion Section E of Chapter 4).

2. ***Variable rate demand bonds.*** Variable rate demand bonds are bonds the holders of which may tender them back to the issuer or its agent upon short notice (usually 7 days, but may be 1 day, 1 month or other periods), for a purchase price equal to par plus accrued interest. As a result, they bear interest at rates like, and have some other characteristics of, short term obligations. Variable rate demand bonds generally require a bank letter of credit, standby purchase agreement or other facility to assure liquidity in the event bonds are tendered and cannot be remarketed. Unless the issuer is highly rated, variable rate demand bonds are typically also credit enhanced with either bond insurance or bank letter of credit or other credit facility. The advantages of variable rate demand POBs are that (i) their interest rates are generally lower than fixed rate bonds, and (ii) they are usually subject to redemption at any time without premium and at no extra interest rate cost for the right to redeem. However, while the interest rate usually starts out lower than fixed rate bonds, the rate is variable and subjects the issuer to interest rate exposure and risk to the interest rate savings objective and to the risk arbitrage pension fund investment objective for issuing the POBs (see discussion in Sections A and C of Chapter 3). Interest rates may be affected not only by market conditions but also by the financial condition of the issuer or the credit provider or liquidity provider. In addition, there are risk, costs and aggravation associated with renewal of any bank liquidity or credit facilities, which usually have a term of one to five years, compared to the POBs which typically have a term of more than 20 years.

3. ***Auction rate bonds.*** Auction rate bonds appear to be the most popular current variable rate mode at this time because they do not require a bank letter of credit, standby purchase agreement or similar liquidity facility required for variable rate demand bonds or commercial paper. This is because auction rate bonds are not puttable back to the issuer but instead are subject to periodic auction (typically every 7, 28 or 35 days) if the holder would like to dispose of its bonds other than by direct sale. The interest rate is reset by the auction price and tends to be materially less than the then current fixed rates (for example, in the fall of 2003, 7 day auction rate taxable POBs bore rates of roughly 1.05%–1.15% compared to 30 year taxable fixed rates of approximately 5.95%). However, there is no assurance that auction rates will not increase to exceed the fixed rate at which the POBs could have been originally issued. If there is an auction with no buyers (*i.e.*, a failed auction), the interest rate

usually goes to the maximum rate (typically 12 to 15%). Failed auctions are rare. The primary reason they may occur is (i) a cloud of some kind on the tax-exemption of the bonds (for example, an IRS audit or challenge to the tax-exemption of similar bonds), which is not a risk for most POBs because they are taxable; or (ii) a shock to the security for the bonds (for example, bankruptcy of an important source of revenue) which is improbable with general fund obligations like POBs unless the issuer goes bankrupt (which states cannot do under U.S. bankruptcy law, and cities and counties do very rarely).

4. ***Indexed bonds.*** Indexed bonds are variable rate bonds that are not subject to tender back to the issuer and, therefore, do not require a bank liquidity facility, and bear interest at a fixed spread over a market index (typically either three or six month LIBOR) reset at the end of each accrual period (typically quarterly if three month LIBOR is used or semiannually if six month LIBOR is used). LIBOR refers to the London Interbank Offered Rate and is published daily as page 3750 on the Telerate, Inc. news and information service (referred to as the Official LIBOR Page). Indexed bonds of this type are used primarily to facilitate marketing of POBs outside of the U.S. where investors are more accustomed to LIBOR based investments, but are also attractive to many U.S. investors as well. Like auction rate bonds, index bonds may be subject to redemption without penalty. However, also like auction rate bonds there is no assurance that LIBOR indexed rates will not increase to exceed the fixed rate at which the POBs could have been originally issued. However, unlike auction rates, the LIBOR index is not affected by events affecting the POBs issuer or the POBs. Index bonds may also be swapped to fixed more efficiently and with little or no basis risk compared to auction or other variable rate bonds because the global swap market is primarily LIBOR based.

5. ***Capital appreciation bonds.*** Capital appreciation bonds (CABs) are bonds that bear no current interest, which instead is accrued, compounded (usually semiannually) and paid at the maturity of the bonds. They are used primarily to reduce debt service in the early years. A variation is convertible CABs, that function as CABs for several years and then convert on a certain date to current interest bonds (with interest paid on the then accrued value of the bonds, being the original principal amount plus the amount of accrued, compounded interest up to the conversion date). The disadvantage of CABs is that higher rates of interest are required in order to market them.

6. ***Swaps.*** If variable rate bonds are used, the resulting interest rate exposure may be swapped to a fixed rate, in whole or in part, using a floating-to-fixed interest rate swap. While swaps may often make a great deal of sense in this context, they are complex financial investments and beyond the scope of this pamphlet. It is important to make sure that if a swap is to be used, it is consistent with the issuer's objectives and does not itself expose the issuer to risks or consequences the issuer does not fully understand or are inconsistent with its objectives. For example, if the purpose of using variable rate POBs is to allow for refunding or early redemption if rates drop or other circumstances change, the termination payment that may be due on early termination of the swap may offset the benefit of and effectively prevent refunding or redemption. There are also other circumstances in which a substantial termination payment may be due from the state or local government such as default of the swap provider or downrating of either party, as well as other terms that can be modified to suit the state or local government's objectives. Expert advice should be sought before entering into any swap.

D. Payments to the Pension Fund: Whole or Part

POBs may be issued to pay all or any part of the UAAL or (depending on applicable state law) the normal annual contribution.[1] Frequently, issuers choose to use POBs to fund only a portion of the UAAL, generally to avoid or reduce the concerns described in Chapter 4. The portion of the UAAL funded may be (1) a percentage of the total UAAL as of the date of issuance of the POBs, or (2) all of

[1] Depending on state law and financing structure, it may also be possible to finance future year's normal annual contribution and/or unfunded liability created by investment losses not yet realized due to actuarial smoothing methodologies (which phase in investment gains and losses over a period of, usually 3 to 5, years).

certain years contributions to the UAAL. If agreed to by the pension system, the second approach can result in suspension of all UAAL contributions during those years (for example, the next succeeding 10 years). At the end of the period, the UAAL will be recalculated and amortized over the remaining original term of the UAAL. The risk of this second approach to partial payment of the UAAL, which is much less common than the first approach, is that if investment performance of the pension fund is substantially below the assumed rate of return, there could be a significant increase in the amount of UAAL to be amortized over the remaining term. To a degree, that risk can be addressed by subsequent issues of POBs (before or after the date of recalculation).

CHAPTER SIX

Tax Issues

A. Taxable Bonds

Most POBs are taxable. That is, interest on the bonds is included in gross income for federal tax purposes although they are usually exempt from income taxes of the state in which the issuer is located. This affects not only the interest rate at which the POBs are sold but also the types of investors to which they are marketed (for example, corporate pension funds, charitable endowments and others not subject to federal income tax and, for some of the larger issues, non-U.S. investors). There are, however, a few circumstances in which POBs may be tax-exempt.

Why most POBs are taxable, with these few exceptions, is explained below.

B. Tax-Exempt POBs Prior to 1986 Tax Act

Prior to the enactment of the Tax Reform Act of 1986 (the "1986 Tax Act"), POBs that were properly structured could bear interest that was excluded from gross income for federal tax purposes. However, to get tax-exempt treatment, investment of bond proceeds for the benefit of the covered employees and former employees had to be designed so that the issuer/employer did not benefit from the investment in any way other than relieving the issuer of the responsibility of paying its retirees.

If proceeds deposited in the pension fund were expected to be invested in securities or obligations with a yield higher than the yield on the POBs, the issuer's obligation to make additional contributions into the fund would be reduced in the future, a

prohibited anticipated direct benefit from the investment of the bond proceeds by the pension fund.

However, the situation was different where the issuer contracted with someone else to take over the responsibility of making payment to the retirees and paid for that transfer of risk with proceeds of POBs – for example, by purchasing an insurance company annuity whereby the insurance company took over all liability for the payment of the pension benefits. In that case, the insurance company bore the risks and benefits of investment return – the issuer got no benefit from investments made by the insurance company even if the expected investment return was reflected in the price paid by the issuer for the annuity policy. In addition, the purchase of an annuity was not treated as the purchase of a "security" or "obligation" under the tax law. A number of tax-exempt POB transactions were consummated in the early 1980's in which the proceeds were deposited into a pension fund and were used to acquire insurance company annuity contracts.

C. Tax Reform Act of 1986; Transition Rules

1. ***Stopping New Issues of Tax-Exempt Pension Bonds.*** As a result of the threat of a proliferation of tax-exempt POB issues, Congress decided to amend the tax law to prevent the investment of tax-exempt bond proceeds in annuity contracts. New rules were adopted in the 1986 Tax Act. "Investment type property," including annuity contracts, was added to "securities" and "obligations" as potential arbitrage investments. In addition, because of the urgency with which it viewed the matter, Congress included a special effective date rule in the 1986 Tax Act relating to annuity contracts which applied to all bonds issued after September 25, 1985. The 1986 Tax Act essentially ended the issuance of tax-exempt POBs for the purpose of depositing the proceeds into a pension fund or for the purpose of purchasing annuities to replace the issuer's responsibilities to its retirees, except as described below.

2. ***Transition Rules for Refundings of POBs.*** The status of refundings of pre-1986 Tax Act POBs was not specifically addressed in the 1986 Tax Act. In connection with two later tax acts, the Technical Corrections Bill of 1988 and Technical and Miscellaneous Revenue Act of 1988, Congress attempted to clarify its position on refundings. While the statutory language and legislative history are a bit confused, the related House, Senate, and Conference Committee Reports indicate that Congress intended generally to permit one advance refunding of pre-September 25, 1985 POBs (at least where the amount of the refunding is not greater than the amount of prior bonds). Additionally, the legislative history indicates that Congress intended to permit any number of current refundings of pre-September 25, 1985 POBs where the refunding bonds do not additionally burden the tax-exempt market, but merely replace existing tax-exempt debt.

D. Columbus Case

The State of Ohio created a state fund into which municipal corporations in the State were required to transfer, on January 1, 1967, all existing assets and liabilities of their local pension funds for police and firefighters. Under the State law, all pension liabilities accruing after the transfer would be supported by current employer and employee contributions. However, while the State fund completely assumed the assets and liabilities of a city's retirement fund, the law mandated the city pay to the fund, either immediately or over time, an amount equal to the present value of the accrued but unfunded liability determined at the time of the transfer. The City of Columbus opted to satisfy its obligation over time together with the required interest.

In 1993, the State modified the law to allow any city still owing money to the fund to extinguish its remaining UAAL in return for a single payment equal to 65% of the then unpaid principal balance. The City decided to prepay its obligation. However, upon hearing that the City was going to issue tax-exempt bonds to fund its prepayment, representatives of the Internal Revenue Service notified the City that they would assert that interest on these bonds would be taxable. The City sought a private letter ruling from the Internal Revenue Service and received an adverse ruling which it appealed to the Tax Court.

In the court proceedings the Service argued, among other things, that the discount the City received on the prepayment of its obligation to the fund was a form of

investment return and thus created impermissible arbitrage profit. The Service reasoned that the pricing of the prepayment reflected the expectation of the State fund that it would be able to invest the amount of the prepayment at a yield materially higher than the yield on the City's bonds. As a result, the Service believed that both the City and State fund would benefit form the earnings on the investments. In addition, the Service argued that the prepayment constituted the use of bond proceeds to acquire "investment-type property" at a yield higher than that on the bonds (after taking into account the discount received on the prepayment) in that absent the discount pricing of the prepayment there would be no economic savings for the City.

Ultimately, the City prevailed on appeal as the Court of Appeals concluded that there was an existing obligation of the City to the State fund, the City would not benefit from the investment of amounts by the State fund and the prepayment of the City's own debt obligation to the State fund did not constitute the acquisition of investment type property by the City. The City was then able to refund its obligation to the State fund by issuing tax exempt POBs.

While the unusual facts in this case have application beyond the City of Columbus, such application is likely to be fairly limited and to attract unfavorable attention from the Internal Revenue Service.

E. Tax-Exempt Working Capital Bonds

While directly issuing bonds to deposit the proceeds into a pension fund does not appear to be permitted under current tax law governing tax-exempt bonds, in certain cases it may be possible for a state or local government to indirectly fund the current year's pension deposit. For example, a state or local government may issue short term tax or revenue anticipation notes or long term working capital bonds to finance a cash flow budget deficit or a so-called structural budget deficit. The deficit analysis would include any cash flow deficit relating to the state or local government's obligation to deposit amounts into its pension fund.

It may be that this type of financing is best done so that the bond proceeds are not required to be deposited in the pension fund, but rather, are used to fund deficits created by working capital expenditures including the deposit of amounts into the pension fund. In other words, it is important that the bond proceeds not be "traced" into the pension fund or required to be deposited there and the bonds should not be called Pension Obligation Bonds.

Among other things, long term bonds of this type would bring into play the application of some complex federal tax rules relating to when proceeds can be treated as spent, allocation of the deficit in sizing the issue, permitted amortization structure, the application of so-called "other replacement proceeds" rules, applicable yield and other investment restrictions, post-issuance compliance matters, plus the intersection in sizing and in post-issuance compliance with the issuance of normal tax or revenue anticipation notes and any other short term or long term working capital obligations.

F. Investment of POB Proceeds in Municipal Obligations

The primary tax problem in the use of tax-exempt POBs to make a deposit to a pension fund is that the proceeds are not treated as spent, but rather are treated as invested. Moreover, under the so-called "proceeds spent last" rule applicable to working capital financings, these proceeds cannot be treated as paid out to pension recipients until all other available amounts are first expended, which as a practical matter, means that the proceeds will never be deemed expended. Unless the investment yield on the investments in the pension fund is not more than the yield on the bonds, the bonds will become taxable arbitrage bonds. In addition, the "hedge bond" rules would result in the bonds being treated as taxable hedge bonds unless the issuer actually expected to spend the proceeds within a three- or five-year time frame, taking into account the "proceeds spent last" rule.

However, under both the arbitrage rules and the hedge bond rules, interest on the bonds used to fund the pension fund could be tax exempt if the issuer invested the proceeds of the bonds in municipal obligations the interest on which is not subject to the alternative minimum tax (so-called "non-AMT" municipal bonds). Under these provisions as long as the amount of non-AMT municipal bond investments in the

pension fund is at least equal to 95% of the amount of POBs outstanding at any time, interest on the POBs will be tax exempt. As the POBs are amortized, there is a similar reduction in the amount required to be invested only in non-AMT municipal bonds in the pension fund.

While this structure allows for POBs to be issued as tax exempt, the benefit of a tax exemption on the bonds may be outweighed by the limitation on the type of investments allowed with the proceeds.

G. Other Considerations: Effect on TRANs

Tax and revenue anticipation notes (TRANs), are typically issued by state and governmental units of all sizes to fund the annual cash flow deficit which arises due to the timing mismatch between annual revenues and annual expenses. TRANs are almost always issued as short term notes with maturities of 13 months or less and are repaid at or shortly after the end of the fiscal year by which time it is expected that revenues will have "caught up" with expenses. To the extent the POB proceeds are used to fund a deposit to the pension fund that otherwise would have been made out of current year's revenues, the deficit will be likely be reduced by the same amount, impacting the sizing of any TRANs issued for that year. The one circumstance where this would not happen is if the calculation of the maximum cash flow deficit used in sizing the TRANs shows that it is incurred prior to the time of the pension deposit. In that case, the use of proceeds to make that deposit would not have any impact on the size of the TRAN issue.

CHAPTER SEVEN

Federal Reimbursement Issues

Certain costs of state and local government in administering programs under grants from or contracts with the federal government are eligible for reimbursement from the federal government. Such costs include compensation and benefits, including pension benefits, of state or local government employees for the time devoted to the administration of such programs. Such allocable pension benefit costs even include the interest assigned to the state or local government's unfunded liability. The principles governing such reimbursement are set out in Office of Management and Budget Circular A-87. Some states have similar programs for reimbursement of local governments for costs related to the administration of state programs.

POBs replace the state or local government's payment of some or all of these pension costs with payment of the principal of and interest on the POBs. Issuers will want to be comfortable that the federal government will treat debt service on the POBs as the surrogate for the pension obligations funded or refunded with the POBs and will continue to reimburse its allocable share. Statements have been issued by the Office of Management and Budget and the Department of Health and Human Services to the effect that the POBs, including principal (representing amounts paid to the pension fund), interest and costs of issuance, will be allowable as the pension costs funded or refunded thereby, so long as the POBs are not more costly to the federal government than the regular pension costs funded or refunded over the remaining life of the unfunded liability. The same principles should apply to refunding POBs. Further details of federal and state reimbursement programs are beyond the scope of this pamphlet.

CHAPTER EIGHT

New York

A greater number of POBs (roughly $5) have been issued by the state and local governments in New York over the past decade than from any other state.

The issuance of POBs by local governments in New York was first authorized in 1989. The State and Local Employees Retirement System of the State of New York ("ERS"), the New York State Police and Fire Retirement System ("PFRS") and the New York State Teachers Retirement System ("TRS", in the aggregate referred to as the "NYS Retirement System") were all modified in 1989 with respect to the method by which the annual contribution amounts were to be calculated in the future. As a result, each system was significantly underfunded, requiring a "catch-up" payment to return to actuarial full funding. Participating local governmental units were offered the option of (1) amortizing the UAAL amount due by a date certain through a direct loan from the State which carried an 8% (for TRS) or 8¼% (for ERS and PFRS) rate of interest until the liability was fully met, or (2) financing the UAAL through the issuance of general obligation bonds over a statutory period (applicable to the particular retirement system), or (3) paying cash by the date certain. Few local governments, except small jurisdictions with few employees, took the third option.

During the period 1989 through 1993, counties, cities and larger school districts, in particular, issued general obligation bonds to pay off their then current balance of unamortized UAAL whenever interest rates dipped sufficiently to permit a lower net interest cost on their own bonds than the 8% or 8¼% rate being charged by the State. During this period, local governments could issue ten year general obligation bonds with net interest costs in the range of 6% to 7.375% depending on their credit rating. The 1989 legislation further provided that at such time as the remaining amortization period was less than five years, local governments could no longer issue

their own debt to pay off the outstanding balances. Thus, with a permitted maximum statutory amortization period of seventeen years for most UAALs, the possibility of financing of the 1989 UAALs ended in the 2001-2002 fiscal year of most local governments.

Beginning in 1995, the State adopted legislation almost every year creating new retirement incentive programs for various categories of State and local government employees, largely to support a goal of efficient downsizing of government. Generally, the legislation establishing these programs did not at the time include provisions for financing of the resulting unfunded liabilities. Such costs, which added to any existing UAAL, were paid either by amortization through the NYS Retirement System or by cash.

Concurrently in this time period, another type of pension-related program was developed by the State legislature which authorized local governments to create service award and defined benefit programs for volunteer ambulance and fire-fighting personnel. The legislation permitted the financing of contributions to certain of such programs attributable to years of volunteer service rendered during the five years prior to adoption of such programs. Such financing cannot be amortized over a period exceeding five years.

In 2003, new legislation was adopted for the purpose of structural reform in the method and manner of employer contributions to the NYS Retirement System, which legislation also included two provisions for the issuance of POBs:

1. Local governments are now permitted to issue POBs for any outstanding obligations to the State for any existing retirement incentive program (*i.e.*, the retirement incentive programs established annually in the years from 1995 through 2002). (This provision was drafted by Orrick attorneys on behalf of the New York State Association of Counties.) The amortization period is limited to five years.

2. Similar to the 1989 legislation, a local government (and the State itself with regard to its own employees) is permitted to amortize a portion of its normal annual contribution for one fiscal year – that is, local governments are permitted to amortize the amount due on December 15, 2004 to the ERS or PFRS component of the NYS Retirement System (except deficiency payments, adjustments relating to prior year payments, obligations for retirement incentives or other similar amounts) to the extent that such amount exceeds 7% of the estimated "pensionable salary" base for the then current fiscal year (2004–2005). This "amount eligible for amortization" may be amortized over a five year period at 8% with the State, or local governments are authorized to issue their own debt obligations to pay such amount, with maximum maturity not to exceed five years. On or about October 15, 2003, the State Comptroller is to determine the "amounts eligible for amortization."

The only type of financing specifically authorized for POBs in New York State are general obligation bonds (which obligations include a pledge of the full faith and credit and taxing power of the local government). These bonds must be issued in the same manner, under the same procedural requirements and subject to the same debt limits and other constraints as for any capital project of the local government. Mandatory or permissive referendum requirements applicable to general obligation bonds of the particular type of local government apply to bond resolutions authorizing POBs. For example, school districts must receive voter approval before issuing debt for any purpose authorized by the 2003 legislation. (Note that the legislation in 1989 exempted such school district POBs from the voter approval requirement; this omission in the 2003 legislation may be corrected during a future legislative session.) Likewise, fire districts would need prior voter approval. The bond resolutions of counties, towns and villages which authorize payment for five years or less are not subject to mandatory or permissive referendum. Similarly, city bond ordinances should not be subject to mandatory or permissive referendum unless specified by applicable special city charter provisions.

Once a bond resolution has been adopted by a local government authorizing the issuance of POBs, it is generally necessary to publish a legal notice of estoppel including a summary of the bond resolution and allow the 20 day estoppel period to elapse prior to the sale of the POBs. The purpose of the estoppel notice is to ensure that debt issued by the local government cannot be challenged on any basis.

procedural or otherwise, except on constitutional grounds once the estoppel period elapsed.

The New York State Legislature has also authorized the State itself to borrow in order to fund its UAAL on at least two occasions. In 1996, the State through the Dormitory Authority of the State of New York issued $773,475,000 of POBs as annual appropriation debt. These bonds had a final maturity in 2003. The 2003 legislation described above also amended the State Retirement and Social Security Law to authorize the State to amortize a portion of the State's contribution bill for the fiscal year ending March 31, 2005. The amortizable portion is calculated in the same manner as that permitted local governments. Likewise, the State may either amortize that portion through the office of the State Comptroller for five years at 8% or issue POBs.

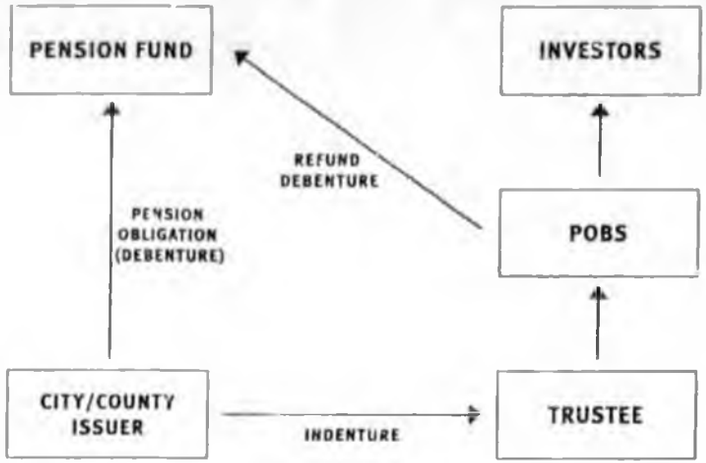
CHAPTER NINE

California

Pension obligation bonds had their start with the famous City of Oakland, California pension bond financing in 1985, the first POB in the country, which Orrick helped to invent and for which it served as bond counsel. That financing and a number of copy-cats that rapidly followed were tax-exempt and primarily driven by then legal arbitrage possibilities. As explained in Chapter 6, tax-exempt POBs largely came to an end with the introduction of tax legislation that became part of the Tax Reform Act of 1986.

A new taxable version of POBs surfaced in late 1993. During the last decade since, thirteen or so cities and seventeen or so counties in California have issued over 60 POBs (second only to New York) aggregating more than $11 billion (more than from any other state). With the exception of one tax exempt transaction rule (see Chapter 6C) POB transactions issued as lease revenue bonds, all of these POBs have been issued under the local agency refunding law (drafted by Orrick a few years before for other purposes). California cities and counties do not have specific authority to issue POBs.[4] However, the local agency refunding law is available to all local public entities in California to refund prior bonds or "other evidence of indebtedness." The pension obligation to the county pension system, the California Public Employees Retirement System or other retirement system is memorialized as a "debenture," thereby becoming an "evidence of indebtedness," which can be refunded by POBs under the local agency refunding law.

[4] The State of California enacted specific authority for State POBs in 2003.



The POBs are typically structured as obligations payable from the general fund of the city or county issuer. They are not full faith and credit taxing power general obligation bonds backed by the issuer's taxing power, because the California Constitution's debt limitation requires such type of bonds to be approved by two-thirds of the electorate. Instead, California POBs have generally been designed to be valid without voter approval under a judicially created exception to the State Constitution debt limitation, which exception is generally referred to as "obligations imposed by law". See discussion in Section A2 of Chapter 5. Because this exception to the Constitutional debt limit was and is much less developed in the case law (few cases not directly on point) than the other two judicially created exceptions (for lease financing and revenue bonds) each POB issue in California has been validated pursuant to California's validation statute (Code of Civil Procedure §§860 *et seq.*).

While there have been many validation actions for POBs, so far they have all ended with a default judgment and no published opinion, meaning that they have no precedential value or application to any transaction other than the specific transaction(s) validated.

What is validated in such validation actions is not legal principles but the bonds and the other principal legal documents approved in a bond resolution. Before the validation action is filed, it is necessary for the state or local government issuer to first adopt the resolution and authorize the bonds, the documents and the validation action. The validation action is filed in the superior court of the county in which the issuer is located, and an order for publication of summons is received. Summons can then be published (usually in a newspaper of general circulation in the city or county in which the issuer is located), which takes a minimum of 21 days. If no one answers the complaint by the date specified in the summons, which must be at least 10 days after completion of publication, the clerk can enter a default, and schedule a hearing before the judge for the default judgment (the timing of which will depend on the jurisdiction, and may be a day or two or, in some jurisdictions, at least 15 days after the clerk enters the default).

So assuming the very best case, obtaining a validation judgment takes a minimum of 31 to 46 days (depending on the jurisdiction) after filing the validation complaint. Of course, issuers are at the mercy of the judge and the clerk, and it sometimes takes a week or more to get an order for publication of summons, or longer than 15 days after the clerk enters a default to schedule the hearing. In addition, the judge could take the matter under submission for an indefinite amount of time, or even disagree with the proposed default judgment, and decline to validate the transaction. Once granted, the default judgment may be appealed on jurisdictional grounds within 30 days. Therefore, it is typically assumed that the validation action will take approximately 60 days (not including the appeal period). It is generally considered reasonable to sell the POBs without waiting for the 30 day appeal period to run, assuming no one has answered the complaint, because the grounds for appeal are so narrow, but usually the bond closing does not occur until after the appeal period has expired.

If someone does answer the complaint, then there is true two party litigation on the merits. While some expedited procedures are available, the timing for resolution of the litigation cannot be predicted, and may take many months unless settled or abandoned. So far, no one has answered the complaint and default judgments have been obtained for every city and county POB issuer. However, the same was not true of the State of California, whose validation complaint was answered by the Howard Jarvis Taxpayers Association, and resulted in a decision on September 23, 2003 by

the Sacramento County Superior Court declining to validate the State's proposed POBs, which decision, as of this writing, is being appealed by the State.

The validation actions can and usually do validate not only the POBs to be issued but also any future POBs or refunding POBs. Not all validation actions are as inclusive or as flexible as they could be (some leaving out future new money or refunding POBs or costs of issuance or locking in semiannual interest payment dates, etc.), and must be carefully reviewed before relied on for future POBs or refunding POBs.

Note, as mentioned in Section A2 of Chapter 5, that the "obligations imposed by law" concept that is generally used to support POBs in California does not support reserves or capitalized interest because inclusion of such components in the bond issue are considered volitional not mandatory (as evidenced by the numerous California POBs issued without them) and therefore not "obligations imposed by law." Costs of issuance, on the other hand, can be included on the theory that they cannot be avoided. The inability to include capitalized interest makes achieving current budget relief more challenging (see discussion of structure options in Section C of Chapter 5). Alternatively, the POBs could be issued as annual appropriation bonds or asset strip lease revenue bonds (see Section A3 and 4 of Chapter 5), which can include reserves and capitalized interest.

CHAPTER TEN

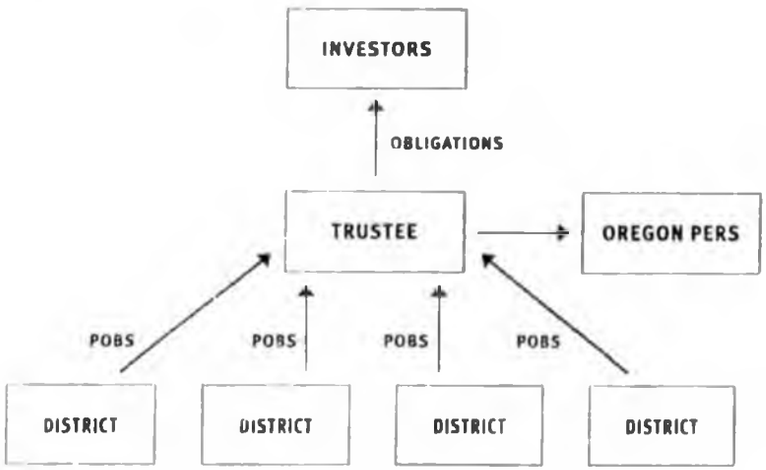
Oregon

State and local government issuers in Oregon have been among the most active users of POBs to finance their share of unfunded liability to the Oregon Public Employees Retirement System. POBs are issued in Oregon either as limited tax bonds or as revenue bonds.

Prior to the passage of the Pension Bonding Act in 2001, the City of Portland, Multnomah County and Josephine County issued significant sized POBs under Oregon's Uniform Revenue Bond Act. In 2001, the Oregon Legislative Assembly approved the Pension Bonding Act (which Orrick attorneys were involved in drafting). The Pension Bonding Act granted authority to "governmental units," including cities, counties, school districts, special districts, public corporations and intergovernmental corporations, to sell full faith and credit obligations for the purpose of refinancing pension obligations. POBs issued under the Pension Bonding Act are not subject to voter approval or annual appropriation and may be issued by local governments individually or jointly.

Significant pooled POB issues have been done by Oregon school districts, community college districts and local governments. In these transactions, the participants pledge their full faith and credit within the limitations of the Oregon Constitution and issue limited tax bonds, payable from available general funds of the issuer. Available general funds include all ad valorem property tax revenues received from levies under each issuer's permanent rate limit and all other unrestricted taxes, fees, charges and revenues legally available to pay debt service on the POBs. The issuers are not authorized to levy additional taxes to pay the POBs.

In the pooled school district and community college district transactions, individual districts issued limited tax POBs in favor of a bond Trustee, which in turn issued obligations that represent a proportionate and undivided interest in and right to receive POB payments pursuant to a Trust Agreement. The POBs were further secured by an Intercept Agreement between the State Department of Education and the school districts and community colleges under which the Trustee was authorized to intercept specific education revenues otherwise paid by the State to the school districts and community colleges in an amount equal to the debt service on each issuer's POBs. Specific examples of recently completed Oregon pooled POB issues include: $153,582,299.60 Oregon Community College Districts Limited Tax Pension Obligations, Series 2003 (Federally Taxable); $927,079,763.45 Oregon School Boards Association Limited Tax Pension Obligations, Series 2003 (Federally Taxable); and $238,743,693.40 Oregon Local Governments Limited Tax Pension Obligations, Series 2002 (Federally Taxable). Each of the pooled transactions have been enhanced by bond insurance. By pooling these transactions, the issuers were able to increase the amount of bonds sold, which increased access to investors, and to lower interest rates and reduce costs of issuance.



Other jurisdictions, including the City of Portland, City of Corvallis, Multnomah County, Marion County, Josephine County, Eugene Water and Electric Board and Portland Community College District have sold POBs on a stand-alone basis.

As an alternative to issuing POBs as limited tax bonds pursuant to the Pension Bonding Act as described above, issuers have the option to issue POBs as revenue bonds pursuant to the Uniform Revenue Bond Act or the Pension Bonding Act. The Uniform Revenue Bond Act allows municipalities to issue revenue bonds for any public purpose secured by designated "revenues," which may include taxes and virtually all other general and special fund revenues and receipts of the municipalities. The Uniform Revenue Bond Act requires notice and a 60-day referendum period during which revenue bonds are normally subject to referral to a vote of the electorate if within the 60-day period 5% or more of the voters file petitions requesting a vote on the bonds. Revenue bonds issued pursuant to the Pension Bonding Act are exempt from this requirement.

In a special election on September 16, 2003, Oregon voters approved an amendment to the Oregon Constitution that authorizes the State Treasurer to issue POBs as general obligation bonds of the State of Oregon for the purpose of paying substantially all of the State's UAAL. The amendment provides that the general obligation of the State must contain a direct promise on behalf of the State to pay the principal, premium, if any, and interest on that indebtedness. The State also will pledge its full faith and credit and taxing power to pay that indebtedness; however, the ad valorem taxing power of the State may not be pledged to pay that indebtedness. The amount of POB indebtedness authorized by the amendment that may be outstanding at any time cannot exceed 1% of the real market value of all property in the State. The State presently expects to issue approximately $2 billion in POBs and to list them on the Luxembourg Stock Exchange in order to facilitate sales to European investors.

In 2003, the Oregon Legislative Assembly made substantial changes to Oregon PERS. The amount of litigation surrounding PERS in Oregon is increasing, and a

number of challenges to the legislative changes are pending in the courts. Several lawsuits have been filed in the Oregon Supreme Court and in the federal district court in Oregon seeking to have changes that were enacted to PERS enjoined or declared an unconstitutional impairment of contract or unconstitutional taking of property. Although these cases are not directly related to any particular bond issues, their outcome could have far-reaching implications with respect to PERS and related liability.

CHAPTER ELEVEN

Similar To POBs

Pension obligations are similar to other state and local government non-bond obligations, which it may be possible to fund in a manner similar to POBs. While this pamphlet is intended to cover primarily POBs, and they are the most frequently used and highly developed of this category, it is useful to note, at least briefly, that there may be other applications of the same concepts discussed above. Several examples (not an exhaustive list) may include such other actuarially based insurance or benefit obligations as workers compensation, health benefits and unemployment insurance or such non-actuarial obligations imposed by law as court rendered judgments for damages against the state or local government and, in California, county obligations under the Teeter delinquent property tax program.

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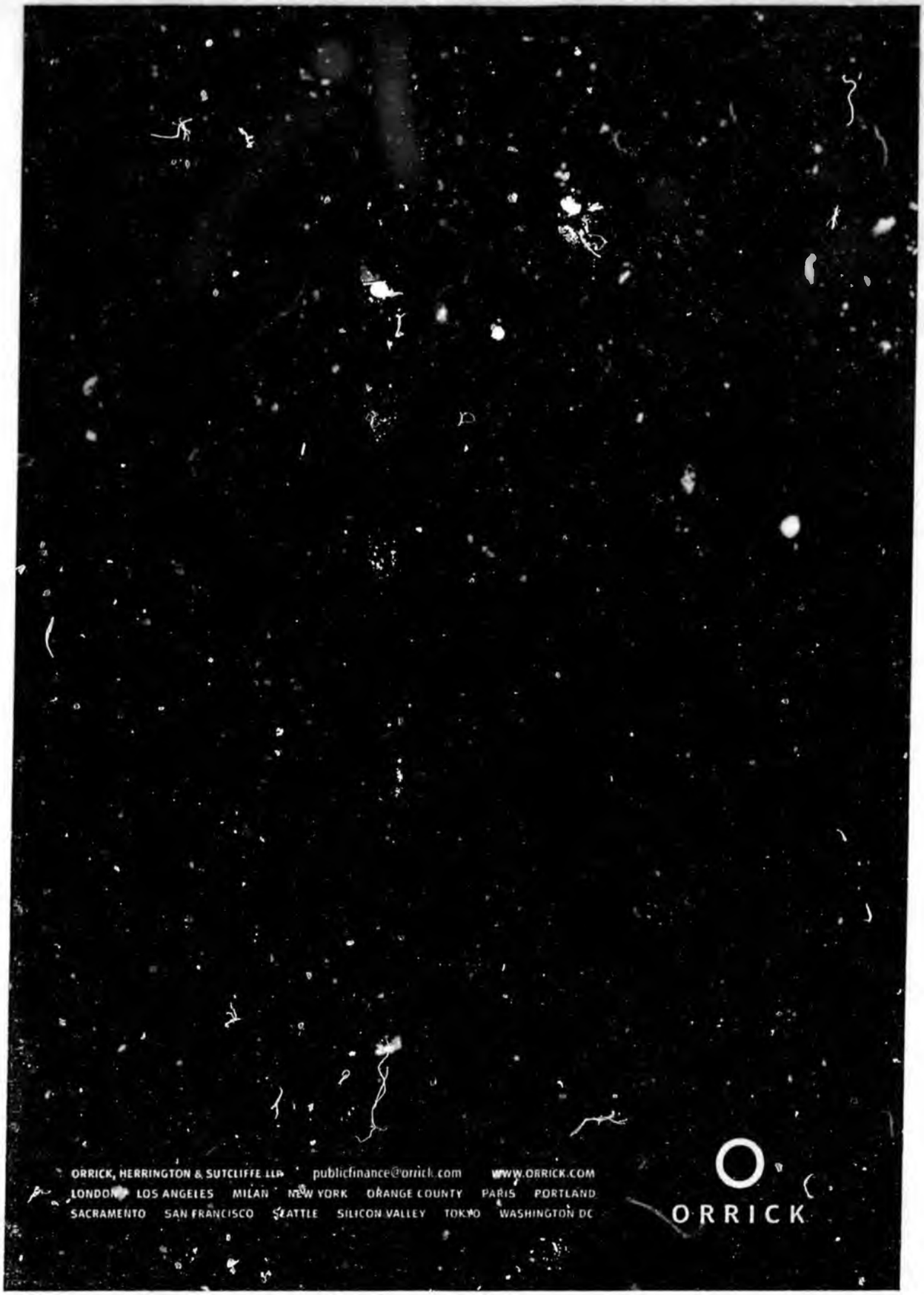
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Research:

Pension Obligation Bonds Are Surging After Brief Hiatus

Publication date: 20-Jan-2004
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Pension obligation bonds (POBs), the once-arcane debt instrument used to finance unfunded pension liabilities, have returned with a vengeance after a brief hiatus, and are again making their mark on the public finance landscape. A number of conditions have fallen into place to spark this resurgence, including:

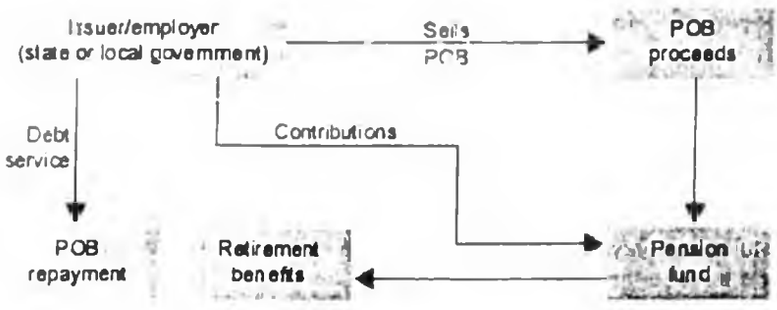
- The rapid growth in unfunded liabilities for public pension funds over the last few years, driven by investment losses, benefit enhancements, and greater longevity of pension plan beneficiaries;
- The relatively low interest-rate environment, which widens the spreads between the POB interest costs paid by the issuer/employer and the assumed investment return rate of the pension systems, which makes the economics of the transaction more attractive; and
- The potential cost savings from a POB, as many state and local employers struggle with budgetary imbalances and other savings alternatives become scarce.

Because of the confluence of these factors, POBs are back. This report details the mechanics of how POBs work, their history, the special risks unique to this debt instrument, the critical rating factors and implications, and future prospects.

How POBs Work

While the financial implications of POBs are complex, the actual mechanics are relatively simple. Generally, the municipal employer will use the findings from the most recent actuarial valuation, or have a new valuation completed, to determine the pension system's unfunded actuarial accrued liability (UAAL). Then, it will decide what portion of the UAAL (either all or a part) will be funded with the POB. In the 1990s most employers funded the entire UAAL, but for various reasons discussed below, many now tend to finance less than the full amount. Once the POB is sized and sold, the net proceeds are placed in the pension trust fund to be commingled with the other funds, and usually invested according to the existing asset allocation guidelines (see Chart). Thus, the pension fund experiences a rapid increase in assets resulting in a higher funded ratio (actuarial value of assets divided by actuarial accrued liability). For the POB to generate savings for the employer, the investment return rate on the POB proceeds must be greater than the interest cost of the bonds (and ideally equal to, or exceed the pension system's investment return assumption), and the larger the spread between these to two rates the better. The employer, as POB issuer and obligor, would then be projected to achieve lower total pension contribution and debt service costs than it would have if it had not sold the POB.

Pension Obligation Bond Mechanics



Brief History

While there were a few issues in the 1980s, the first big wave of POBs really came in the early 1990s. By the end of the decade about $15 billion of POBs had been issued. The years 2000 and 2001 were slow from a POB standpoint, with 2000 correlating to the apex of U.S. public pension funding at an average funded ratios of slightly over 100%, up from only about 80% in 1990. These robust funding gains were fueled by above-average equity returns during the period and a general shift in the weighting of public pension assets to this asset class from fixed-income. The corollary to a high funding level is a lower or nonexistent UAAL. Falling funding ratios, now estimated to be heading towards the 90%, have been exacerbated by a combination of adverse circumstances, some uncontrollable and some self-inflicted. These factors include the decrease in asset values from poor equity returns and the increase in liabilities from benefit enhancements and demographic changes (for example, members living longer). The second wave of POBs, driven by burgeoning unfunded liabilities, has come on strong in 2002 and 2003. As in the first wave, California counties have been leading the pack, and there are a number of repeat borrowers, but there are also significant new players. The state of Illinois, which issued in June of this year, now holds the POB record for sheer size at $10 billion — almost four times larger than the previous record. Oregon sold a $2 billion issue last fall, and other states that have recently completed or plan a POB sale include Kansas, Wisconsin, and West Virginia.

POB Risks

The principal risks to the issuer of a POB fall into a number of categories:

- Arbitrage (investment return/POB interest cost);
- Leverage;
- Market risk; and
- Political.

POBs are essentially an arbitrage play, the success of which is dependent on the premise that the pension fund assets (including POB proceeds) will earn on average more than the interest cost on the POBs and hopefully the assumed investment return rate (generally about 8%) or better each year for the life of the bonds. If the bonds are sold at an interest cost of 6%, for example, the spread could generate handsome savings if the investment returns goals are met over the life of the bonds. The problem is that there is no certainty that the average 8% return will be realized over time, and therein lies the principal risk of the POB to the issuer. If the pension fund earns 8% or more on the POB proceeds, then the result will be success by virtue of having to pay lower pension-related costs (contributions plus POB interest) than without the POB. However, if the investment return is less than the POB interest cost, the transaction becomes a drag on cash flows. Not only will the employer have the new POB debt service costs but also higher contribution rates attributable to new unfunded liabilities from under performing investment returns. If returns are above 6% (as in the example above) but below 8%, the employer will have increasing contribution rate costs, but it would have had them even without the POB. When investment returns are less than the POB interest costs, the POB puts additional strains on financial operations rather than helping.

While the 1990s produced some impressive investment returns, no pension fund consistently earns 8% or higher every year in perpetuity; returns vary dramatically and may (or may not) average the investment return assumption or even the POB interest rate cost. The POB paradigm has a goal to average or beat the 8% investment return assumption over the long-term. With the appropriate asset allocation strategy this goal may be attainable, but market experience over the last several years has led some to believe that an 8% return assumption may be too aggressive.

Another factor in evaluating the success of a POB is that its full effect can only fully be tallied at final maturity of the bonds. Due to market gyrations, a POB may look like a great success for several years, or even a decade, only to see investment gains erode, and at maturity are pronounced a failure. Conversely the exact opposite may be true, with poor results in the early years later overcome to achieve projected benefits in the final analysis.

In any event, we do know that even if projections are right on average over the life of the POBs, there will be years with returns that are higher, and some that are lower (maybe significantly), than the 8%

bogey. We do not have to look back very far to see evidence of such swings: in fiscal 2001 the S&P500 index of domestic equities fell 16%, in 2002 it fell another 19%, but in 2003 it fell only 1.6%. These market declines hurt issuers with POBs outstanding: most had to pay increased contribution rates to cover the new actuarial losses, plus they had the higher debt service costs due to the POB.

The risk of adding too much leverage is another factor for POB issuers to consider. Borrowing for any purpose increases leverage, and incurring debt to pay unfunded liabilities is no different. While the issuer is substituting one type of long-term liability (POB) for another (UAAL), there is a difference. In most cases, bond debt service is a "harder" obligation than the "softer" contribution payments used to amortize the UAAL. Bond debt service must be paid in full and on time or the issue falls into default, with wide ramifications. For certain employers, contribution payments, on the other hand, may be temporarily deferred or reduced without serious negative consequences. Therefore, the size of the POB relative to the total debt structure of the issuer must be measured in terms of what level of debt service can be managed if actual future investment returns do not meet the original POB plan projections.

Because POBs generate very large infusions of funds into the pension system compared with the more steady investment and reinvestment of interest, dividends, and contributions by the fund, the plan for investing POB proceeds must be considered. Should the monies be invested according to the existing asset allocation guidelines, or should POB proceeds have a special allocation strategy because of current market conditions or expectations? If the chief investment officer of the fund believes that international equities, for example, are overvalued, maybe a delay in filling that allocation would be warranted. On the other hand, in that pension funds are long-term investors, most have stuck with their traditional allocations for proceeds, eschewing market timing strategies. Whatever the strategy may be, it should be fully vetted before the POB sale.

Another aspect that few envisioned when this instrument was first initiated is the political risk hidden, almost like a Trojan horse, within the POB structure. As was mentioned in a feature on this subject, ("Pension Obligation Bonds: Unique Rating Documentation", RatingsDirect, March, 4, 1999), POBs can become victims of their own success. For example, if a POB is issued for the full UAAL, resulting in a 100% funded ratio, and subsequent higher-than-average returns push the ratio to 110% or 120%, there will arise tremendous political pressure to distribute the so-called "excess" funding by increasing benefits, thus incurring new liabilities. The excess funding touted in the late 1990s turned out to be illusory. Even systems bolstered by POBs that did not increase benefits found themselves in under funded positions following the market declines from 2000 to 2003. Those that fell victim to the siren's song and increased benefits have even lower funding levels. Some pension funding ratios declined to the extent that the employers' opted to go back to the market to issue POBs for a second time.

Analysis

The rating process for POBs basically parallels that of long-term debt with similar security plus with certain additional analytical factors pertinent to the POB and pension system. Most POBs issued to date have a GO or general fund pledge. Also, a high percentage of those sold have been additionally secured by bond insurance. In Standard & Poor's analysis specific to POBs we focus on the effect of the bonds on the issuer's debt structure and its ability to meet its obligations. The financial review includes the impact on both the balance sheet and the operating statement or cash flows. The status of the issuer's pension fund on a pro forma basis is also part of the review as with any similar analysis.

From the balance sheet perspective, we look at how the POB fits into the issuer's total debt plan. Does the POB dramatically alter the issuer's debt profile? We look at total debt with and without the POB so as not to penalize a POB issuer in comparison to another issuer that might have relatively low debt (and no POBs) but sizable unfunded pension liabilities. Also, we evaluate the leverage added by the POB. Does it markedly increase hard, fixed costs (bond debt service) in place of a softer, more discretionary obligation (pension contributions)? If sub par investment returns put upward pressure on contribution rates will they, coupled with the new higher debt service costs due to the POB, put the issuer's budget under greater strain? The issuer must also be cognizant of the effect the POB issuance may have on statutory debt limits. Will the POB use up debt capacity that might be needed for other, more pressing needs?

From a cash flow standpoint, Standard & Poor's reviews projected debt service and contribution costs, with and without the POB, including the validity of the assumptions including those for POB interest

costs and pension fund investment returns. How do the projections compare in total and on an annual basis? The spread between interest costs and investment return generates the savings expected from the transaction. What is the magnitude of annual savings and total present value savings? Where (in what years) are the savings taken? Are the savings front-loaded in an attempt to mask budgetary stress? Will any front-loading lead to higher, unsustainable contribution rates in later years? Do the potential savings form the POB outweigh the risks involved The analysis of the cash flows is a critical component to understanding the full impact of the transaction.

As part of the POB analysis we also review the current status of the recipient of bond proceeds — the pension system itself. What is the statutory relationship between the issuer/employer and fund? How have the laws and precedents for making contributions affected funding progress and how do they play into the POB strategy? Have funding levels generally been increasing over time? What are the funding goals and how will the POB impact these objectives?

The pension fund's general actuarial methods and assumptions also will be reviewed for comparative purposes. The fund's asset allocation strategy will be studied for consistency with the POB assumptions and for the general risk profile. An aggressive investment strategy may make the POB objectives more difficult to achieve on a consistent basis.

Rating Implications

Employers looking to help manage their unfunded liabilities through the issuance of a POB should weigh the pros and cons very carefully. Any applicable risks from the above list should be evaluated. There should be a clear POB plan with attainable actuarial and investment assumptions and a conservative structure. Prudent allocation for projected savings over time limits the chances for problems

It is possible for POBs to have a negative effect on credit quality, especially in the investment environment over the last several years or if they were structured poorly at the outset. Standard & Poor's will continue to evaluate POB risks in light of each employer's individual profile at the time of sale as well as their projected effects over time. POBs may work as planned over the long-term, but short-term fiscal dislocations resulting from these structures are part of their baggage.

Special Rating Documentation Requirements for POBs

The unique nature of POBs requires certain additional documentation not normally requested for other types of ratings:

- POB financing plan, including its effect on the overall debt plan;
- Projections of UAAL contributions and debt service with and without the POB;
- Latest pension fund annual report;
- Most recent actuarial valuation and experience studies of the fund; and
- Pension fund's current asset allocation strategy and plan for investing POB proceeds.

Return to Regular Format

Research:

Managing State Pension Liabilities: A Growing Credit Concern

Publication date: 20-Jan-2005
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State governments have a long history of providing retirement security for their employees--and in many cases certain local government employees--through large, defined benefit pension systems, which, throughout the 20th century, had been successful in meeting their intended goals. However, after state pension funds reached their apex of financial soundness, based on funding levels in 2000, they have since deteriorated--in many cases precipitously--leaving most funds with the problem of managing new, large unfunded liabilities. The rapid growth and significant magnitude of these liabilities has become an increasing credit concern for many state ratings, reaching crisis proportions in some cases.

This article provides a brief overview of public pension funds in the U.S., along with the factors leading to their current status and some of the options available for managing pension liabilities. In addition, the status of a number of state funds, with a range of funding levels, and some of the strategies states have used to address their respective pension situations, will be examined.

Historical Background

Defined benefit pension plans, as used by most states, provide a systematic method for setting aside sufficient monies to pay promised retirement benefits to employees in the future. The benefits are funded by contributions, usually from both employer and employee, and the investment income derived from such contributions. Most states have two principal funds: one for state employees, and possibly certain local government employees, called public employee retirement systems, and one for teachers, referred to as state teachers' retirement systems. Some have one, monolithic system for all government employees (state and local), while others have multiple systems for individual job specialties, such as judges and safety officers.

Public pension funds in the U.S., of which the lion's share of assets belong to state funds, have come a long way from their humble beginnings--some dating to the beginning of the 20th century. Starting with little or no assets to offset liabilities, and some initially operating on a pay-as-you-go-basis, pension funds gradually improved their funding ratios (actuarial value of assets divided by actuarial accrued liability) to the 50% level in the mid-1970s, and further to around 80% by 1990. Early on, pension assets were invested largely, if not exclusively, in fixed income investments. Gradually, investment strategies became more diversified, however, and by the end of the 1990s public funds had increased their allocations to equities and other higher yielding asset classes significantly. This shift in allocations coincided with, and to some extent was fueled by, the bull markets in domestic equities that lasted from the early 1980s through fiscal 2000. At June 30 (the fiscal year-end for most public pension funds), 2000, the average funding ratio for all U.S. public funds was slightly above 100%, and was even higher for state funds.

The party to celebrate the final defeat of unfunded pension liabilities was short-lived, unfortunately, as dark clouds soon began to appear. Trends that would adversely affect actuarial balance impacted both liabilities and assets. Liabilities were being inflated not only by normal growth and inflationary pressures but also by overt changes in benefits and actuarial assumptions. The late 1990s saw a number of improvements to pension benefits, which automatically boosted liabilities, and the actuarial consequences of many of these changes really kicked in after 2000 due to the normal delayed reaction in contribution increases. Demographic and lifestyle trends--along with the resultant assumption changes, such as retirees living longer (a global phenomenon) and more employees taking early retirement--had a similar, expansionary effect on liabilities. However, the biggest component in the steep decline in funding levels from fiscals 2001 to 2003 came from the asset side, and was caused by the bottom falling out of the domestic equity markets. The investment return assumption requirement for most public funds to maintain actuarial balance, about 8%, could not be sustained when the average allocation to domestic equities stood at 40%-50% and the annual returns of the S&P 500 Index were

negative 13%, negative 19%, and positive 2% in fiscals 2001, 2002, and 2003, respectively. The net result was that, by June 30, 2003, average funding ratios for state funds had fallen from an average overfunded level in 2000 to an estimated 80%-90% in just three short years. While the S&P 500 saw a 17% gain at fiscal year-end June 30, 2004, public pension fund actuarial results, on average for the year, will not report major funding gains due to the effects of the actuarial smoothing of gains and losses over a period of years used by most. With five-year smoothing, for example, a fund in fiscal 2004 would still be accounting for a portion of the losses (or gains) from the prior four years.

Alternatives to Improve Funding

The range of options to fix a pension mismatch of assets and liabilities is relatively narrow, and almost all are difficult to implement due to legal, economic or political impediments. Corrective measures should act to stop or slow pension liability growth or grow assets, or both. From a liability standpoint, most states have constitutional or statutory pension benefit protections that preclude any reductions in benefits already promised to existing employees. One way around these restrictions is to close off the current benefit to new employees and offer new employees a reduced level of benefits. This tactic of creating a new tier of benefits has been used by a number of funds to reduce liability growth. Completely closing existing plans and creating new, less generous defined benefit plans, and even new defined contribution plans, is another option.

Changing actuarial assumptions to reduce liabilities has been used in the past; the current demographic and economic realities related to the major variables, however, make these options difficult. The raising of the actuarial investment return assumption to 8.25% from 8.00%, for example, would automatically lower actuarial liabilities, all other assumptions being equal. However, the investment experience over the past three or four years and current expectations would tend to preclude such a change at this time.

The principal options to improve pension balance by increasing assets fall into three main categories:

- The pension fund may alter its asset allocation strategy to enhance investment returns;
- The pension fund sponsor may sell pension obligation bonds (POBs), placing the proceeds in the pension trust and thus reducing or eliminating the unfunded actuarial accrued liability (UAAL); and
- Annual contribution rates for sponsors or employees may be increased.

Pension funds in the U.S., as major global investors with more than $2 trillion in assets, have developed sophisticated asset allocation plans over the years, and, with access to professional asset managers, attempt to maximize returns within their prescribed tolerance for risk. For an individual fund to dramatically enhance yields by altering its allocations, there would most likely need to be a sea change in thinking about the fund's view of risk. Minor tweaking of strategies is a more regular occurrence as funds seek to keep up with changing markets, risk profiles, and expected returns of various asset classes, but major strategy changes leading to markedly improved results are rare.

Some states, as sponsors, have opted to pursue the POB route to significantly boost assets in one bold move, while at the same time taking advantage of the projected lower carrying charges this vehicle offers to a sponsor. (For further information, see report titled "Pension Obligation Bonds Are Surging After Brief Hiatus," published Jan. 20, 2004, on RatingsDirect). While no panacea, POBs are basically an arbitrage play based on the premise that, as a result of the bond proceeds being invested at an expected yield above the cost of the bonds, net savings will be achieved by the sponsor over the life of the bonds. In other words, after the issuance of the POB, combined debt service plus pension contribution costs will be lower than they would have been without a POB. The success of this formula depends on the realization of a certain investment return, which is in no way guaranteed. Whether a POB succeeds or fails cannot fully be evaluated until the final maturity of the bond, and it is a given that some years will be winners and others losers. The bad years may add short-term fiscal stress to the POB issuer (pension sponsor), which could be significant based on the amount of leverage the POB exerts. With most POBs having been issued over the past 10 years or so, it would be premature to pronounce them an unqualified success (or failure). The best that can be said to date is that POB results have been mixed, with some having met or exceeded expectations while others have come up short based largely on the vicissitudes of market timing.

The last major option for increasing assets, and the most common alternative used to manage new, unfunded liabilities, is to simply increase annual contribution rates. Indeed, a major principle of an actuarially funded defined benefit plan is that, if assets and liabilities become unbalanced, increasing

(or decreasing if the system is overfunded) contributions will bring the system back into balance. Sometimes employee contributions are increased, but usually it is the sponsor that steps up to the plate: the investment risk of a public defined benefit plan and the burden to make good on benefit promises are ultimately the responsibilities of the sponsor. Thus, the principal byproduct of the current state pension funding crisis has been increasing contribution costs coming at a time when states, in recent years, have been squeezed by weak revenues and burgeoning expenses, including security and health care cost pressures.

How Are Some States Managing Their Pension Liabilities?

Arizona.

The Arizona State Retirement System, a multiple-employer defined benefit plan, provides pension benefits for employees of the state, political subdivisions, and public schools, with more than 500 employers and 222,000 active members. The system's funded ratio fell to 98.4% at June 30, 2003, after a decade of more than 100% funding. As reported in the June 30, 2003, actuarial valuation, the major contributor to this decline was investment losses for the year that resulted in a decrease in the actuarial value of assets by $1.2 billion. In November 2002, the state retirement system board removed the requirement that actuarial assets be within 20% of market value, and changed the period for recognizing investment gains or losses to 10 years fr ve years. At June 30, 2003, the system's market value of assets ($18.1 billion) was 77% of actu value. The 2003 actuarial valuation developed hypothetical contribution rates for both employees and employers (odd-year calculations are not actually implemented) of 6.96% each, compared with 1.92% each in 2001.

California.

California has two large state pension funds: one for state and certain local employees--California Public Employees' Retirement System (CalPERS)--with assets exceeding $170 billion; and the other for teachers--California State Teachers' Retirement System (CalSTRS)--with more than $115 billion in assets. These systems have been experiencing some of the same pressures as pension funds in other states, and have experienced declines in funding levels. For example, the funded ratio for the state member category of CalPERS had fallen to 84% as of June 30, 2003, compared with 111% in 2000. State contributions to CalPERS for its employees, as actuarially determined, have risen from $160 million in fiscal 2001 to $2.2 billion in fiscal 2004. In the same vein, the funded ratio for the CalSTRS defined benefit plan fell from 110% in 2000 to 82% in 2003. However, total amounts contributed to CalSTRS by members, employers, and the state, as set by statute, increased just 10% during the same period.

A number of changes for both pension systems have been proposed over the last year. In relation to CalPERS, the state's 2005 budget included certain pension reforms, such as a two-year delay of contributions into CalPERS from new miscellaneous and industrial employees, thus obviating the state's obligation to make contributions on their behalf over that period. A $900 million POB was proposed, the proceeds of which would be used to pay a portion of the current contribution payment as opposed to paying a portion of the unfunded actuarial accrued liability like most other POBs. Court validation of the POBs is being sought. The 2005 state budget also included proposals to increase employee contribution rates and lower benefits for new employees to pre-1999 levels.

In December 2004, CalSTRS proposed a number of options to help address the funding deficiency in its defined benefit plan. At June 30, 2003, the system's unfunded actuarial obligation totaled $23.1 billion. The first option was for the state to issue a POB to pay down the entire liability. Other options included a change in the amortization period of the unfunded liability and a number of changes to how benefits are calculated. One option that could have a large effect on the amortization cost is to eliminate the 2% benefit adjustment. Several alternatives included increases in contribution rates by all three contribution bases: members, employers, and the state.

On July 1, 2003, the state did not make its full contribution payment to CalSTRS' supplemental benefit maintenance account, although it did make the required payment to the system's defined benefit program. The state paid $59 million of the $559 million required supplemental benefit maintenance account amount. In October 2003, CalSTRS filed suit in Sacramento County Superior Court to have the $500 million payment restored. The state is currently defending the action.

Of late, proposals to replace the two California state defined benefit plans with defined contribution plans, and to eliminate state contributions to CalSTRS, have been actively debated.

Florida.

The Florida Retirement System was created in 1970. The system was created to provide a defined benefit pension plan for participating employees. The plan is administered by the state division of retirement in the department of management services. Participation by local governments in the state is optional, but is generally irrevocable once the government opts to participate in the plan. Currently there are 866 participating employers and 956,875 individual participants. Of the total participants, 23.5% are retirees and beneficiaries. Contrary to trends for most other states, the actuarial value of assets in the system has consistently exceeded the actuarial accrued liabilities in recent years. The funded ratio of the pension system has ranged from 112% in fiscal 2004 to 118% in fiscal 2000. Investment performance in fiscal 2004 was strong, with a return of 16.6% compared with the 7.75% assumed rate of return. The actuarial value of assets at July 1, 2004, was $106.7 billion. The solid asset position of the Florida Retirement System has provided budget relief in the form of lower contribution requirements for the state and participating local governments.

Illinois.

Illinois sponsors five defined benefit retirement plans for about 630,000 members and annuitants, including public employees, teachers, university personnel, and judges. By 2003, the funded ratio of the Illinois funds ranked near the bottom compared with other states in the U.S. Contributing to the $26.9 billion increase in unfunded liabilities from 2000 to 2003 were:

- Contribution shortfalls ($4.8 billion of the total),
- Investment losses ($14.1 billion), and
- Benefit improvements ($3.3 billion).

Adding to the state's pension woes is a 2002 early retirement incentive plan for state employees, which resulted in a liability that, at $2.5 billion, was quadruple the original estimate. Part of the variance was due to a much larger number of employees (11,032) taking part in the program than originally projected (7,215). Due to the requirement of a 10-year amortization of this liability, the early retirement program contribution for 2005 is $382 million, compared with the originally projected $70 million.

In 2003, the state sold a $10 billion POB, the largest on record, using the proceeds to fund a portion of the UAAL ($8.1 billion) and to pay ($1.9 billion) the state's current pension contribution for fiscals 2003 and 2004. The POB increased the combined system's funded ratio by seven percentage points. At the end of fiscal 2003, the funded ratio for the combined systems was 57% (after giving effect to the POB), and the UAAL was $35.8 billion.

New York State.

The New York State comptroller is the sole trustee of the state's common retirement fund, which includes all assets of the New York State Retirement System. Members of the system are typically employees of New York State or employees of municipalities in the state (excluding New York City). As of March 31, 2004, there were 2,985 participating government employers in the system. The overall membership in the system exceeds 970,000; this includes 641,721 members and 328,357 retirees and beneficiaries. Overall, membership has expanded continuously, but the growth from retirees has been most significant. Retirees now make up 34% of the system's members, compared with 26% in 1990. Benefit payments continue to rise, reflecting improvements in final average salaries, cost of living adjustments, and benefit improvements. The increased benefit payments, coupled with the performance of the stock market after 2000, have required significant employer contribution increases, with significant increases forecasted for the next two years as well. At March 31, 2004, about 63% of the pension system assets were invested in various stocks. For the largest component in the system--the New York State and Local Employees' Retirement System--employer contributions had averaged 1.75% from fiscals 1996 through 2003. Contributions will increase in fiscal 2004 to 5.9%, totaling $1.2 billion. This rate is projected to more than double in fiscal 2005 to 12.9%, or a $2.6 billion contribution, followed by an estimated 11.4% contribution rate in fiscal 2006. Similar increases are forecasted in the New York State and Local Police and Fire Retirement System (PFRS) for fiscal 2004. The contribution rates for fiscals 2005 and 2006 are projected to be even steeper for PFRS, however, growing to 17.6% and 16.3%, respectively. These contribution increases have been, and will continue to be, a significant source of budget pressure for the state and its local governments. The legislature has allowed a portion of the increase to be funded with the issuance of bonds or a loan from the state comptroller. For governments that choose this option, fixed costs to service pension contributions will include an interest component, with the fixed costs extended for up to 10 years. The system uses the aggregate actuarial funding method, which does

not identify or separately amortize unfunded actuarial liabilities. Due to the use of this funding method, there is no disclosure or schedule provided on funding progress.

Oregon.

Oregon has historically delivered pension benefits for state and local employees through a single system called the Oregon Public Employees Retirement System (OPERS). After experiencing relatively high funding levels through the 1990s, the UAAL of OPERS at Dec. 31, 2001, was estimated at $9.7 billion, almost three times the prior year. With 2002 investment losses, this figure was estimated to be almost $15 billion--of which about one-third was the state's share. Contributing factors to the increase in UAAL included some of the usual suspects: benefit increases in the late 1990s and poor investment returns. In addition, under the plan, tier-one members were guaranteed a minimum 8% on their regular account assets regardless of actual investment returns earned by the system, and in 2001 and 2002, like most other funds, the system generated negative returns.

In 2003, the state initiated a number of reforms to OPERS, including:

- Modernizing the mortality tables and requiring regular updates;
- Shifting future employee contributions to a defined contribution plan;
- Converting the annual 8% guaranteed rate of return to an assumed 8% to be received over the length of members' service;
- Temporarily suspending future cost of living increases for retirees in certain instances; and
- Creating a new, more independent, retirement system board.

In addition, for new employees hired after Aug. 29, 2003, the state created a new retirement plan called the Oregon Public Service Retirement Plan, which includes both defined benefit and defined contribution components. Employer contributions fund the defined benefit plan, and employee contributions fund the defined contribution plan.

The legislative changes to OPERS resulted in an estimated reduction in the state's UAAL to $2.2 billion from $4.6 billion. A number of lawsuits have been filed challenging some of the OPERS changes. The state intends to continue to defend the challenges. In October 2003, the state sold $2 billion of GO POBs to further reduce its UAAL. The preliminary results of the OPERS 2003 actuarial valuation reported the pension system's funded ratio at about 97%. Employer contribution rates under the valuation showed an increase to 18.27% from 9.96%.

West Virginia.

The West Virginia Teachers' Retirement System (TRS) is a multiple-employer, defined benefit plan for 55 county school systems, certain state higher education employees, and the state boards of education and higher education. The state provides substantially all funding for the system. TRS has occupied the bottom rung among state plans in terms of funded ratios for some time. As of July 1, 2003, the funded ratio was 19%, and the UAAL was $5.1 billion. The state supreme court has ruled that the UAAL of TRS is a public debt, and has required the state to fund TRS in an actuarially sound manner. This requirement entails the elimination of the UAAL over a 40-year period beginning July 1, 1994, enabling TRS to meet cash flow requirements to fulfill future obligations to members.

While for a number of years West Virginia has attempted to clear the way to issue a POB to help lower or eliminate the UAAL in TRS and other state funds, its efforts have been blocked by legal issues, including the requirement for voter approval. If bonding is not an option, the state may have to pursue other avenues to cure its pension ills.

Looking Ahead

States are under varying degrees of pressure to fund the burgeoning liabilities of their pension systems. The common theme lies in developing strategies to manage increasing contribution rates at a time when other demands are conspiring to break the budget: growing health care, education, and security costs to name a few. Options to reduce pension liabilities or even slow their growth, and thus moderate contribution rates, are few and usually difficult to bring to fruition. Even with adequate investment returns, the pension funding problem will be in the forefront for at least a few more years, and possibly much longer if the markets don't cooperate. As if pension liabilities were not enough to handle, states and other governments will soon have to deal with funding issues related to liabilities from Other Postemployment Benefits (OPEB)--largely retiree health care costs. The GASB has established new accounting rules for reporting on OPEB liabilities. (For further information, see report titled "Reporting &

Credit Implications of GASB 45 Statement on Other Postemployment Benefits," published Dec. 1, 2004, on RatingsDirect.) Both pension and OPEB liabilities will act to constrain ratings over the foreseeable future.

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Research: Pension Obligation Bonds: Were They A Good Bet?

Publication date: 08-Nov-2001
Credit Analyst: Parry Young, New York (1) 212-438-2120; Steven J Murphy, New York (1) 212-438-2066

What do the volatility in equity prices and the decline in market indices over the past year or two mean for the security of public pension investments and, further, what is their effect on the strategy, used by a number of governmental pension sponsors over the last decade, of selling pension obligation bonds to fund the unfunded liability of their pension funds? Specifically, given the current and expected market conditions, was the POB strategy a good idea and, if so, does it still have validity, and does this technique represent a viable opportunity for governmental sponsors who may find themselves wrestling with unfunded liabilities as a result of the declines in equity performance?

Brief History

While a few POBs were done in the 1980s, they really came into their own in the 1990s with more than $10 billion being sold. Over the last two years, only a few, relatively small, POBs have been floated. The average principal amount for POBs ranged from $100 million to $300 million with a few exceeding $1 billion or more. Most POBs issued to date have been general obligation or general fund secured, capitalizing on the credit quality of the pension system's sponsor.

The POB Experience Through 2000

With this kind of debt instrument, timing is very important and issuers of POBs in the early- to mid-1990s could not have had better timing. While public pension funds during the 1990s were boosting their average allocations in domestic equities from 33% to almost 50%, the returns on this asset class were sustained at levels well above the historical experience. The average annual increase in the S&P 500 index for the 10 fiscal years ended June 30, 2000 (most public pension funds have June fiscal years), was almost 16%, compared to a historical average of about 10%. The five-year total portfolio return for public funds has averaged more than 13%. These performances should be viewed in the context of average investment return assumptions for public pension systems of only about 8%.

Following the issuance of POBs to increase the funding status or to fully fund a system, this excess return phenomenon could easily result in funded ratios greatly exceeding 100%. However, in that actuarially funded pension systems tend to be self-balancing, this overfunding imbalance would have been corrected by actions taken to affect either the pension fund's assets or liabilities, or both. In these circumstances, pension fund sponsors would, upon the recommendation of their actuaries, decrease or temporarily eliminate pension contributions (contribution holiday), thus slowing the growth of assets. On the liability side, some sponsors made the decision to improve employee benefits, instantly increased liabilities but also balancing overfunding. Regardless of how the "problem" of overfunding was managed by sponsors or pension funds that used POBs prior to fiscal 2000, POBs produced, as promised, an economic benefit and in most cases it was substantial.

2001: Harbinger of Tough Times for POBs?

For the fiscal year ended June 30, 2001, the S&P 500 declined 15.8% (and fell a further 15% in the next quarter), which was its worst performance since fiscal 1982. This fiscal 2001 result followed the below-average performance of positive 6% for fiscal 2000. Following two decades of above-average equity returns, it is probable that these returns will approach the historical pattern going forward.

While a long-term environment of weak investment returns will lower pension funding levels, it may be premature for issuers of POBs and pension funds in general to adjust investment expectations based on the most recent results. As more data become available, if it is apparent that a trend is developing, some reactive changes made be needed. Regardless of the causes, any investment underperformance over an extended period of time will lead to actuarial losses and new unfunded liabilities, resulting in the need to increase contribution rates to bring the systems back into balance. It should be kept in mind that such a need would be in sharp contrast to recent years, when a decrease in the needed contribution rates actually provided budgetary flexibility for fund sponsors. Many funds now use smoothing methods for actuarial purposes in valuing assets to spread investment gains and losses over up to five years. This practice would temper the effects of the fiscals 2000 and 2001 investment return experience. With five-year smoothing, for example, only 20% of the fiscal 2001 losses would be included in the June 30, 2001 valuation, which would still be taking into account prior year gains as far back as 1997.

No matter how sponsors who utilize a POB strategy choose to manage their actuarial gains from the excess investment returns following POB sales (lower contributions or increased benefits), most are likely still fully funded, albeit with a lower cushion. In a long-term lower return environment with declining funding levels, those systems that have taken the bulk of their excess funding out of their POB structure may see trouble ahead.

For example, say a state sold POBs in 1985 with a 30-year amortization to fully fund its retirement system and had average annual investment returns of 12% against its investment assumption of 8%. However, instead of permitting the natural increase in the funded ratio that these conditions would have caused, the state managed its funding ratio, through contribution holidays and benefit improvements, to maintain the ratio at around 100%. If we are in fact heading into a lower return period (the average annual increase in the S&P 500 for the 16 years from 1966 to 1982 was a meager 2.7%, for example), the state may have already reaped all its gains from the transaction structure and be headed for losses. If actuarial losses start to be incurred, contributions will have to increase. If returns fall below the interest cost on its POB that will mean that the POB will have become a net financial drain. If investment yields fall below POB interest cost, total debt service, including that on the POB, plus normal and new unfunded actuarial accrued liability (due to low returns) contributions, will now be higher than if the POB had not been sold. To judge the full effect of a POB, however, any future losses have to be weighed against prior period gains. With a POB, its ultimate success, or failure, can only be judged at its final maturity is approached. The financial dynamics may be a winning formula for 25 years, for example, and then a losing one in the last five years (or vice versa).

POBs Going Forward

Standard & Poor's factors the effects of a pension obligation bond strategy into the long-term rating of the sponsor. Standard & Poor's has viewed POBs as a strategy for savings on carrying charges as long as the transaction was structured conservatively and the assumptions were reasonable and attainable. This requires a clear financing plan including reasonable assumptions and manageable leverage. Prudent expectations for investment returns and the cautious use of resultant savings help insure a POB's success. Another positive factor for a POB is, of course, to be fortunate enough to sell the bonds in a low interest rate environment, thereby increasing the spread between interest costs and investment return expectations and lowering the risk of underperformance. The long-term expectations for investment returns have not yet changed because of the recent return experience or current economic and political conditions and public funds will rely on diversification of investments to maintain necessary total returns. Thus, a sound POB plan today should be as viable as it was 10 years ago. The 2000 Public Pension Coordinating Council Survey of State and Local

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Research:

U.S. Public Pensions Face Uncertain Times

Publication date: 24-Jun-2003

Credit Analyst: Parry Young, New York (1) 212-438-2120; Neil Bukspan, New York (1) 212-438-1792

Public pension plan costs are becoming a bigger drain on U.S. state and local government resources. Many state and local governments have been hit particularly hard in the past several years as they struggle with their worst deficits in decades.

While current government employees watch their pension and other post-retirement benefit contributions rise sharply, a growing number of retired employees are becoming concerned about the future of their own pensions.

As the various governmental jurisdictions decide how they will raise the money needed to fund these mounting benefit obligations, and how to target the root cause of the funding gap, Standard & Poor's Ratings Services is taking a closer look at pension and other post-employment benefits (OPEB) issues. This article examines the credit implications of pension benefit and OPEB obligations and how accountants are revisiting the way municipalities can best reflect the true benefit obligations.

Credit Implications

When Standard & Poor's credit analysts determine the credit implications of public pension obligations, they look at these liabilities in the light of an employer's total debt structure with an eye for what the consequences may be on the employer's ability to pay debt service in meeting these benefit obligations.

"We want to have a reasonably current accounting of the retirement system's funding status, and an understanding of how the employer plans to manage these liabilities," said Standard & Poor's credit analyst Parry Young. "Pension liabilities help shape an employer's credit profile, and the magnitude of the current challenge for some could contribute to rating downgrades. While some previously well-funded plans are in a better position to handle the new liabilities driven by poor investment returns and benefit enhancements, most plans and their sponsors are between a rock and a hard place," Mr. Young said.

Other than facing the music and increasing contributions, the options for employers with increased unfunded liabilities to make significant funding progress are very limited. On the liability side of the ledger, reducing benefit levels, which would lower liabilities, is very difficult to accomplish and frequently constitutionally prohibited.

For example, in the state of Oregon's retirement system, member accounts were credited with a minimum 8% annual return even if the fund's market gains fell below that level. The state is trying to reform this and certain other features of the system, which would reduce the system's total liability by billions of dollars. These changes would be tested in the courts.

Changing actuarial assumptions could also result in decreased liabilities; however, the trends affecting some of the major assumptions are going in the wrong direction. For example, with employees generally living longer, demographic assumption changes usually serve only to increase liabilities. Some sponsors have delayed the implementation of updated mortality tables, but this only delays the inevitable impact on liabilities.

On the asset side, because of the weak investment performance over the last several years, the upside potential for higher investment return assumptions is rather slim. The only recent changes to investment return assumptions have been downward adjustments, which again increases liabilities.

Another option for states is to defer or adjust contributions. In many cases, however,

the states must make the full payment. Partial payments may be possible in any one year, but anywhere from 70% to 90% of employers generally make the full actuarially required contribution. Illinois has a continuing appropriation: once the actuary decides on the rate, the state has to make that contribution. In several California counties, if the board of supervisors does not make the contribution set by the actuary, the county's independently elected auditor must take available county funds and place them in the pension trust fund.

"It's a pretty strong mechanism," Mr. Young said. "Omitting or reducing contributions may be a short-term budgetary fix, but it does not solve the unfunded liability problem."

■ The Pension Obligation Bond Solution

Another solution to funding pensions is for states to issue pension obligation bonds (POBs), the proceeds of which are used to fund the plan and reduce the liability.

"But you are left with a bond on your balance sheet," Mr. Young said. "The primary risk is that you do not achieve a high enough investment return to cover the POB debt service cost or the actuarial investment return assumption, in which case the shortfall results in new unfunded liabilities. Under this scenario, which has been the experience over the past several years, POB issuers are incurring new unfunded liabilities, and higher contribution rates related to that, on top of the additional expense of POB debt service," he added.

Over the long-term, a POB might still be a workable solution, but in the short-term, they may add to fiscal stress, according to Mr. Young. A number of California issuers that issued POBs in the 1990s experienced poor returns, enhanced benefits, and adverse legal decisions, have reached reduced funding levels to the point where they are issuing POBs again. Hundreds of millions of POBs have been sold since May 2002, mainly by California counties, along with more than $15 billion during the 1990s. Several large POB issues are planned or have been completed, including one by Illinois for $10 billion.

■ The Evolution of Pension Accounting

Pension accounting has been dormant for many years, but the weak economic conditions are bringing it to light again, according to Standard & Poor's Chief Accountant Neri Bukspan. Worldwide, accounting standard setters, including the Government Accounting Standards Board (GASB), the U.S. Financial Accountants Standards Board, the International Accounting Standards Board (IASB), and the U.K. Accounting Standards Board have all announced, or are in the process of declaring numerous standard-setting activities related to accounting for pension and OPEBs, including changes to the required disclosures.

For example, the IASB will decide whether "smoothing," a feature that makes it appear that a company is experiencing gains when they are actually recording losses, is acceptable. By 2005, all EU-listed companies are required to adopt International Accounting Standards, and expected to reflect pension and OPEB obligations and related assets.

The recently issued GASB OPEB Exposure is important because OPEB liabilities previously were not required to be reflected as an obligation by governmental equity. However, once the exposure draft is finalized, accounting for OPEBs will substantially conform to the accounting for pensions. Pension and OPEB obligations are difficult for analysts to monitor due to the inherent uncertainties associated with the estimation process, the complexity and inconsistency of the applicable accounting models, and the lack of sufficiently robust and timely disclosures.

To complicate matters, employers use an assortment of plans: defined benefit, defined contributions, insurance contracts, pay-as-you-go, single-employer and multiple-employer arrangements, or any combination of these programs.

The funding requirements also change; the government dictates some and local funding regulators dictate others. "Many times the actual funding to a plan could exceed the minimum funding rules, and different jurisdictions have different objectives

when establishing the minimum funding requirements," Mr. Bukspan said.

Unlike pensions, OPEBs are generally funded on a pay-as-you-go basis, which has a cash stream that is very different from a pre-funding cash stream. However, cash outlays, even in a pay-as-you-go program, can become extensive, particularly because of early retirement and downsizing.

Due to the changing economic circumstances, sponsors are revisiting their pension assumptions, curtailing benefits in many circumstances, and revisiting funding needs and policies. "There are near-term liquidity implications, as evidenced by pension obligation bond issuance, sale of noncore assets, and contributions of noncore assets to the pension plans," said Mr. Bukspan.

Although plan surpluses may be beneficial from a credit perspective, they cannot be viewed as cash equivalents, since the employer's practical ability to tap them directly is generally limited.

In its analysis, Standard & Poor's considers the ability of an entity to actually use the surplus, whether or not it is reflected in its financial statements. Depending on the local laws, when a surplus exists, the employer can curtail contributions, or may use a portion of the surplus to fund other benefits. An employer may also be able to enrich pension benefits in lieu of wage increases and fund downsizing through early retirement programs.

For public pension funds, any "excess" funding advantages flow to a sponsor through the pension contribution mechanism in the form of lower or temporarily omitted future contributions ("contribution holidays"). Laws and regulations do not allow sponsors to directly remove such excess funds from a pension trust fund.

■ The Future of Public Pension Plan Scrutiny

For Standard & Poor's, the challenge is — as it always has been — to collect the most accurate information possible about the potential implications of a benefit plan on the entity's financial position and cash flow to understand the potential exposure involved. Standard & Poor's will be paying close attention to actual and potential liabilities and cash flow requirements of state and local governments arising from pension and other post-employment benefits.

By Will Siss

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February 25, 2005

Representative Mike Hawker
Alaska State Legislature
State Capitol
Juneau, AK 99801-1182

Re: Pension Obligation Bond (POB) Analysis for PERS/TRS

Dear Representative Hawker:

As we discussed at our last meeting in Juneau, we are pleased to present you with our analysis of several options available to the State to improve the financial condition of PERS and TRS. We at UBS would welcome the opportunity to work with you in crafting the most appropriate strategy to accomplish this goal, including the use of pension obligation bonds (POBs) as a low-cost funding mechanism. ***Assuming a POB issue for the total unfunded liability (UAAL) of approximately $5.0 billion, this transaction would generate in excess of $1.6 billion of expected present value savings to the State.*** The State may also determine that issuing a POB for only a portion of its unfunded liability is the most appropriate funding strategy.

UBS is the leading underwriter of POBs nationally and our pension financing team has worked with numerous states and municipalities in evaluating the impact of various strategies to improve the financial health of their public pension systems. UBS believes that POBs should be viewed as one of several tools that the State should utilize in managing its current UAAL. The use of multiple strategies, including POBs, is particularly important for the State since a material portion of the UAAL is due to post-employment healthcare benefits. As you are aware, the combination of a growing UAAL and increasing State contributions to pay down this deficit will have a significantly negative impact on the State's General Fund over the next several fiscal years (and beyond). According to a report by the Division of Retirement and Benefits dated November 3, 2004, the State will face an increase in its contributions of over $108 million in FY06 alone. POBs can not only provide significant expected savings, but also a mechanism to mitigate the negative budgetary impact of paying down the UAAL over the next several fiscal years.

The attached materials are meant to serve as a reference guide for you, and they include our analysis of a POB opportunity for the State as well as published research reports by rating agencies and independent third parties on the benefits and risks of POBs. Clearly, POBs are not a panacea for the challenges of ensuring adequate contribution rates, prudent portfolio management and even overall system oversight. However, given current market conditions, POBs may offer the State an exceptionally compelling opportunity to more efficiently fund its pension system as well as manage the required future contribution rate increases to bring PERS/TRS to more appropriate funding levels.

Again, UBS would welcome the opportunity to discuss POBs and other options available to the State as it looks to address these very important issues.

Sincerely,

James Ziglar, Sr.
Managing Director

John Costagliola
Managing Director

Robert Doherty
Managing Director

cc: Senator Therriault
Senator Stedman

Municipal Securities Group

Pension Obligation Bond (POB) Opportunity for the State of Alaska

Teachers' Retirement System (TRS)
Public Employees' Retirement System (PERS)

February 28, 2005

UBS

Presentation Topics

Executive Summary

Current Funding Status of PERS and TRS

- The combined total unfunded liability (UAAL) of the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) is nearly $5.0 billion as of June 30, 2003
- Unlike most other states, Alaska's UAAL includes liabilities for unfunded pension benefits as well as unfunded post-employment healthcare benefits ("health benefits")

Funding Status	PERS	TRS	Total
UAAL for Pension Benefits	$ (1,356,740)	$ 438,685	$ (919,055)
UAAL for Health Benefits	4,231,112	1,644,639	5,875,751
Total UAAL	2,874,372	2,083,324	4,957,696

Source: Actuarial Valuation Reports for PERS and TRS as of June 30, 2003 ($ in thousands).

- PERS and TRS also have in excess of $445 million of total unrecognized investment losses that are scheduled to be recognized over the next four years
- The UAAL and any recognized investment losses are paid down over a 25-year period and accrue yearly interest charges at a rate of 8.25%
- The cost of paying down this UAAL will have a significant near-term impact on the State's General Fund in terms of increased contributions over the next several fiscal years (and beyond) — a report by the Division of Retirement and Benefits dated November 3, 2004 estimates an additional contribution increase of $108 million in FY06 alone

Executive Summary

Post-Employment Healthcare Benefits

- Rising healthcare costs represent a real and growing threat to the financial condition of PERS and TRS, and by extension to the retirement security of the State's retirees
- Including the cost of health benefits, PERS is 72.8% funded and TRS is 64.3% funded
- Excluding the cost of health benefits, PERS is 121.4% funded and TRS is 89.5% funded

Funding Ratio	PERS	TRS
Pension Benefits	121.4%	89.5%
Total Benefits (Pension + Health)	72.8	64.3

Source: Actuarial Valuation Reports for PERS and TRS as of June 30, 2003.

- GASB Statement 45 will require in 2006/2007 that all qualified public pension plans must begin to account for the cost of their future health benefits, much like Alaska currently does
- Although GASB 45 will not require plan sponsors to actually fund UAALs for health benefits, the State faces significant increases in its healthcare costs and should continue to seek ways to improve its funding of accrued health benefit liabilities

Executive Summary

Pension Obligation Bonds (POBs)

- Pension obligation bonds (POBs) provide a cost-effective and efficient method of improving the funding of PERS and TRS while generating up to $1.6 billion in expected present value savings
- Given current interest rates, which remain near 45-year lows, the State would be able to issue POBs at an all-in cost of funds of approximately 5.20% and eliminate all or a portion of its UAAL
- Compared to the interest charge of 8.25% on its UAAL, the State would save over 300 basis points per year in lower POB debt service payments
- The table below summarizes the expected savings from a scenario that "fully funds" PERS and TRS. The State could issue a POB for just 50% of the total UAAL (or any other percentage) and still generate significant expected savings

Expected POB Savings	PERS	TRS	Total
Deposit to System	$ 3,451,417,000	$ 2,414,746,000	$ 5,866,163,000
PV Savings	954,166,477	685,812,157	1,639,978,634
FY05/06 Relief	58,541,098	44,829,220	103,370,318
FY06/07 Relief	66,583,534	23,618,001	90,201,535
FY07/08 Relief	42,532,756	37,354,146	79,886,902
Total FY05-08 Relief	167,657,388	105,801,367	273,458,754
Gross Savings	2,482,224,569	1,844,531,505	4,326,756,074

- The expected savings from a POB can be structured to generate upfront budgetary relief, mitigate required contribution rate increases and achieve other policy objectives

Executive Summary

Expected Benefits of POBs to PERS/TRS Retirees, Employees and the State

- POBs can and should be viewed as an additional tool to manage the State's funding requirements
- POBs are not "free money" nor without risk; however, if structured properly, a POB transaction can be an efficient, effective and prudent funding mechanism
- POBs are a refinancing option available to the State and PERS/TRS to bring [full] funding sooner and reduce the impact of any necessary future contribution increases
- POBs effectively refinance the UAAL (8.25%) at the lower POB bond rate (5.20%) by replacing current UAAL payments with lower POB debt service payments
- Expected savings from POBs are generally calculated as the difference between existing projected UAAL payments versus the POB debt service that would replace them
- In its simplified form, POBs can be viewed as a refinancing of the State and its employers' UAAL obligations, whose expected savings are dependent upon the effective earnings rate of PERS/TRS over the next 25 years
- POBs are not without financial or policy risks. UBS believes that an appropriate analysis and consideration of these risks is essential and would welcome the opportunity to assist the State evaluate its options to return PERS/TRS to financial health

Managing the State's Funding Deficit

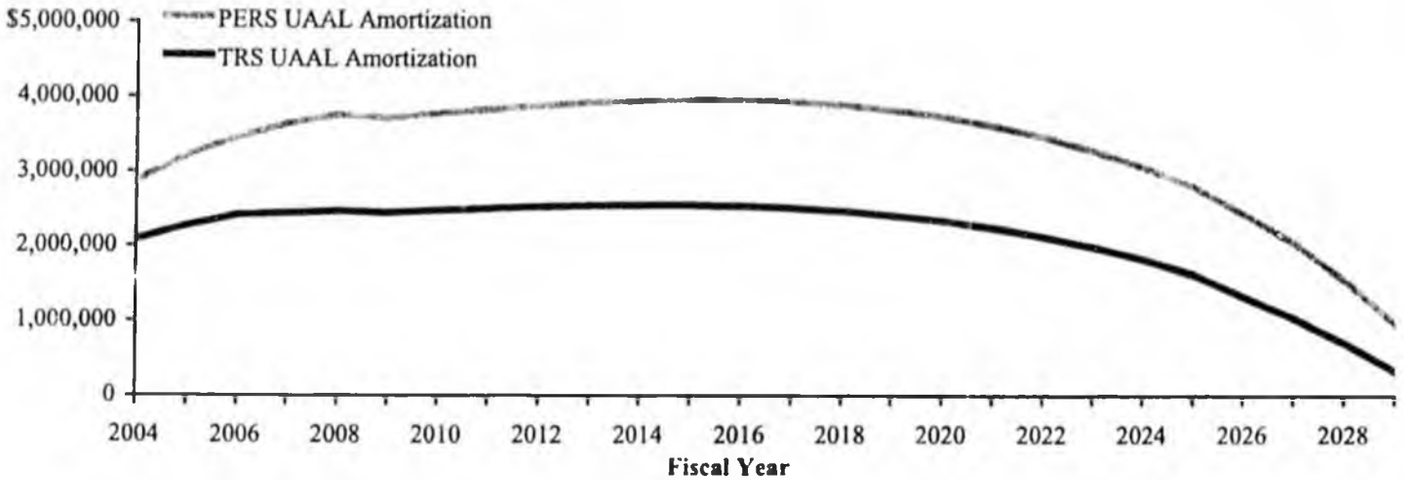
- The key to success is to identify the State's policy objectives and financing goals

- The State has several financial and policy tools available to manage its UAAL:
  - — Increase the State's and/or other employers' contribution rate
  - — Increase the employees' contribution rate
  - — Decrease pension/health benefits
  - — Improve investment returns
  - — Modify actuarial assumptions
  - — Introduce a new "tier" with higher contributions and/or lower benefits
  - — Convert from defined benefit to defined contribution plan
  - — Reduce expenditures for other State services
  - — Issue pension obligation bonds (POBs)

- POBs are just one of many options but have severa unique potential benefits and advantages:
  - — Access to lower-cost borrowing to improve funding ratios and solvency of PERS/TRS
  - — Manage current and future "effective" increases in contribution rates to amortize the UAAL
  - — Fully amortize all or a portion of the UAAL within the time limits established by statute/GARB
  - — Shape POB debt service to reduce UAAL payments in the near term and over the life of the transaction
  - — Generate substantial expected present value savings relative to actuarially determined contribution schedule

UAAL Amortization Schedules

- The current UAAL amortization period is 25 years, as established by the Board
- The total UAAL (PERS + TRS) is projected to increase to $6.5 billion in FY 2015 before beginning to decline

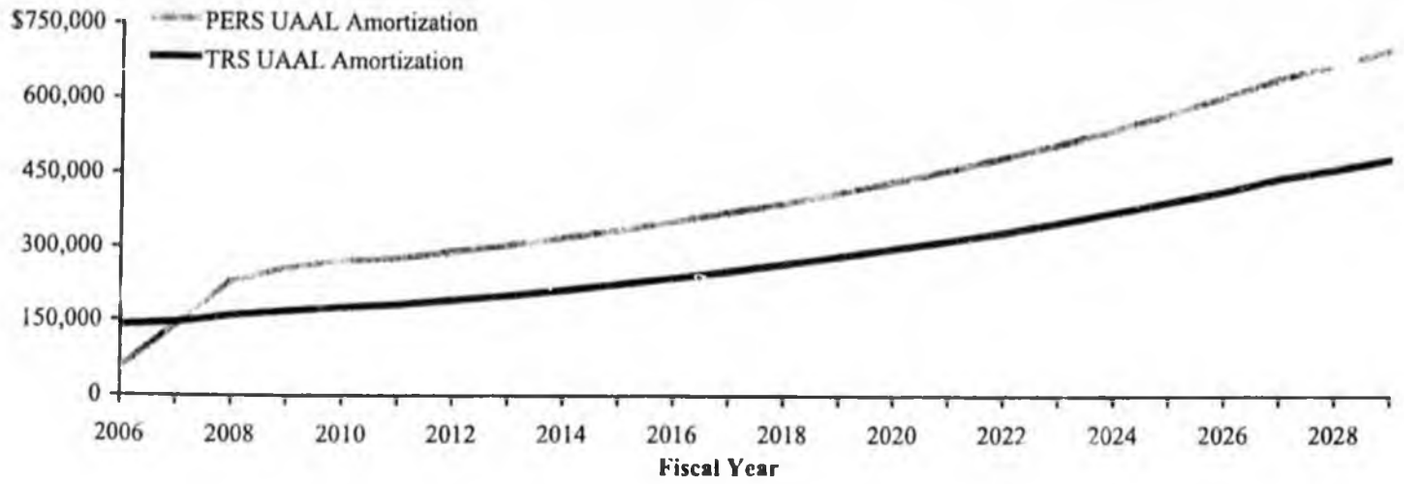


Source: Actuarial Valuation Reports for PERS and TRS as of June 30, 2003 ($ in thousands).

- The actuarially projected amortization schedules illustrated above do not fully pay down the UAAL, but do leave PERS/TRS funded at about the 95% level in 25 years
- A POB may enable the State and its employers to achieve at a lower cost this same level of funding immediately as opposed to waiting 25 years

UAAL Contribution Rates

- The State and its employers are <u>not</u> making sufficient contributions to PERS/TRS at the present time to fully amortize its UAAL over a 25-year period



Source: Actuarial Valuation Reports for PERS and TRS as of June 30, 2003 ($ in thousands).

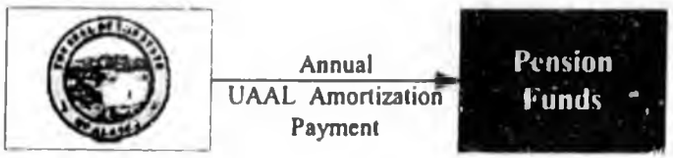
- For PERS, the total employer contribution rate for FY 2006 adopted by the Board is 16.77% versus the actuarially required rate of 25.63%
- For TRS, the total employer contribution rate for FY 2006 adopted by the Board is 21.00% versus the actuarially required rate of 38.85%
- A POB may effectively <u>reduce</u> or otherwise mitigate required future increases in the employer contribution rate with the use of the expected savings from the transaction

Unrecognized Investment Losses

- PERS and TRS have in excess of $445 million of total unrecognized investment losses that are scheduled to be recognized over the next four years
  - — PERS currently has a total of $295.8 million of unrecognized investment losses
  - — TRS currently has a total of $149.7 million of unrecognized investment losses
- These unrecognized investment losses will be recognized equally over the next four years
- As these losses become recognized as part of the UAAL, they will be paid down over a 25-year period and accrue yearly interest charges at a rate of 8.25%
- According to the FY 2004 CAFR for PERS/TRS, "the current asset allocation that the Alaska State Pension Investment Board for the [System's] investments is expected to provide a five year median return of 7.72%"
- Given this expectation, the PERS/TRS Board ought to consider seriously either adjusting its asset allocation or its assumed investment return rate of 8.25%

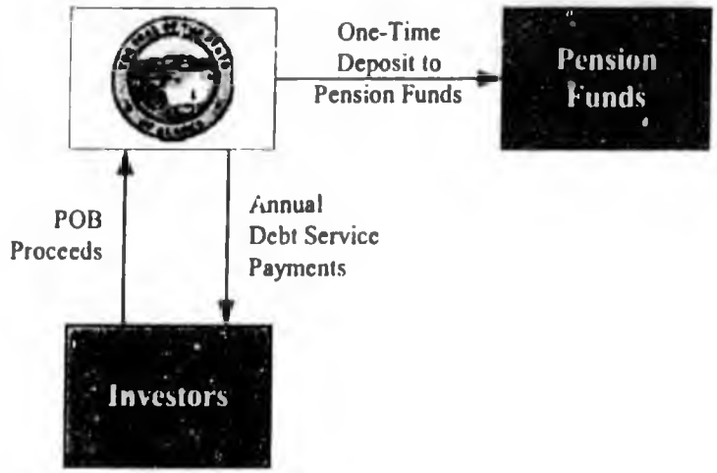
Pension Obligation Bonds (POBs) Overview

Current Plan



- The total UAAL for PERS/TRS is expected to be amortized over 25 years (FY 2029)
- For PERS, the total employer contribution rate is expected to increase over this period from 11.77% to 30.22%
- For TRS, the total employer contribution rate is expected to increase over this period from 16.00% to 47.62%
- Inherent in the amortization schedule is an 8.25% actuarial earnings rate on unfunded liabilities

After POB Transaction



- State issues pension obligation bonds (POBs)
- Bond proceeds to PERS/TRS to pay down UAAL
- State obligation to make UAAL payments replaced with POB debt service payments to bondholders
- Expected savings is the difference between the all–in bond rate of approximately 5.20% and the actuarial earnings rate of 8.25%

Summary of Results

Assumptions	
Dated	07/01/05
Delivery	07/01/05
First Interest	01/01/06
Final Maturity	01/01/29
Term	25.00
PV Factor	8.25%

Expected POB Savings	PERS	TRS	Total
PV Savings (%)	25.82%	28.12%	26.73%
PV Savings ($)	$ 954,166,477	$ 685,812,157	$ 1,639,978,634
FY05/06 Relief	58,541,098	44,829,220	103,370,318
FY06/07 Relief	66,583,534	23,618,001	90,201,535
FY07/08 Relief	42,532,756	37,354,146	79,886,902
Total FY05-08 Relief	167,657,388	105,801,367	273,458,754
Ave. FY09-29 Relief	110,217,485	82,796,673	96,507,079
Gross Savings	2,482,224,569	1,844,531,505	4,326,756,074
Deposit to System	3,451,417,000	2,414,746,000	5,866,163,000

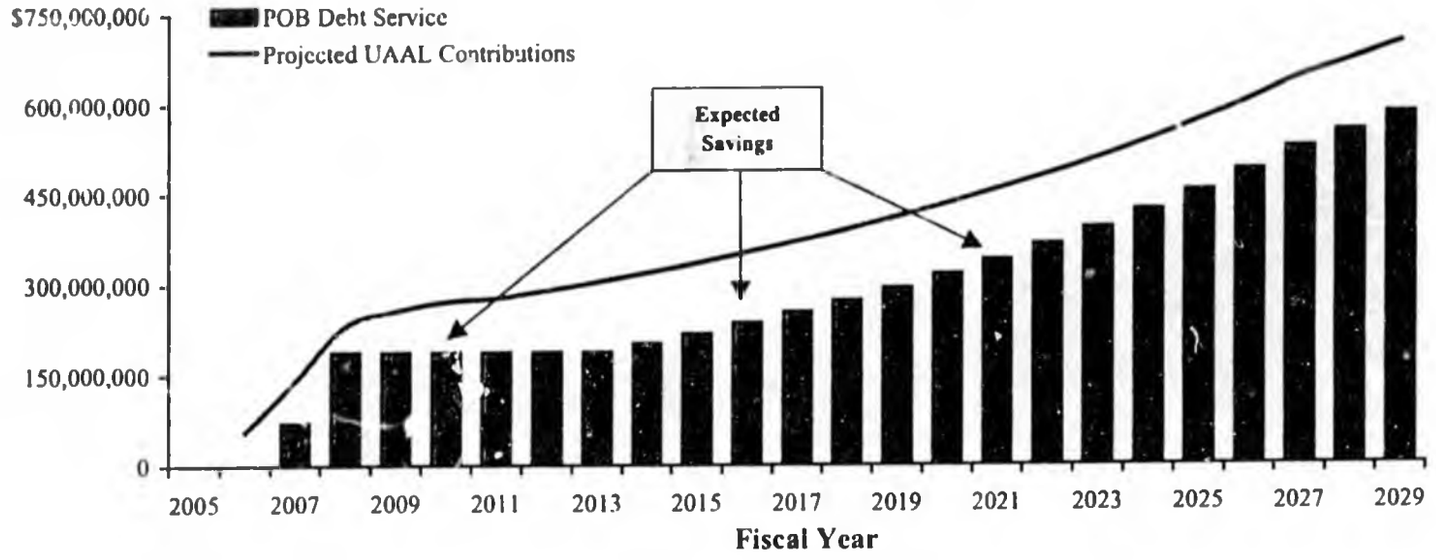
Notes:
(1) Market as of 02/18/05.
(2) Assumes that PERS/TRS earns 8.25% in investment returns.
(3) Assumes a fixed universe of assets and liabilities.

PERS Full Funding Option — 100% of Projected UAAL

Expected PV Savings of Nearly $1.0 Billion

Expected Savings Summary	
All-in Bond Rate	5.19%
PV Savings (%)	25.82%
PV Savings ($)	$ 954,166,477
Gross Savings	2,482,224,569
Deposit to PERS	3,451,417,000

Expected Fiscal Savings	
FY05/06 Relief	$ 58,541,098
FY06/07 Relief	66,583,534
FY07/08 Relief	42,532,756
Total FY05-08 Relief	167,657,388
Avg. FY09-29 Relief	110,217,485

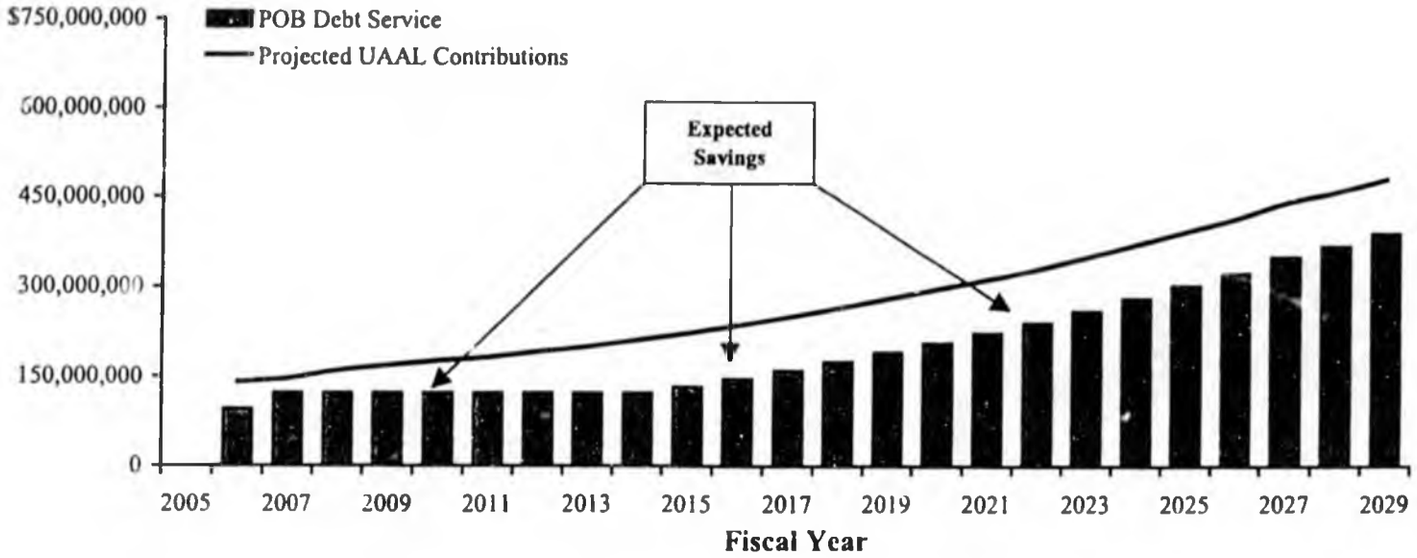


TRS Full Funding Option — 100% of Projected UAAL

Expected PV Savings of $686 Million

Expected Savings Summary	
All-in Bond Rate	5.19%
PV Savings (%)	12%
PV Savings ($)	$ 685,812,157
Gross Savings	1 844,531,505
Deposit to PERS	2,414,746,000

Expected Fiscal Savings	
FY05/06 Relief	$ 44,829,220
FY06/07 Relief	23,618,001
FY07/08 Relief	27,754,146
Total FY05-08 Relief	105,801,767
Ave. FY09-29 Relief	82,796,673

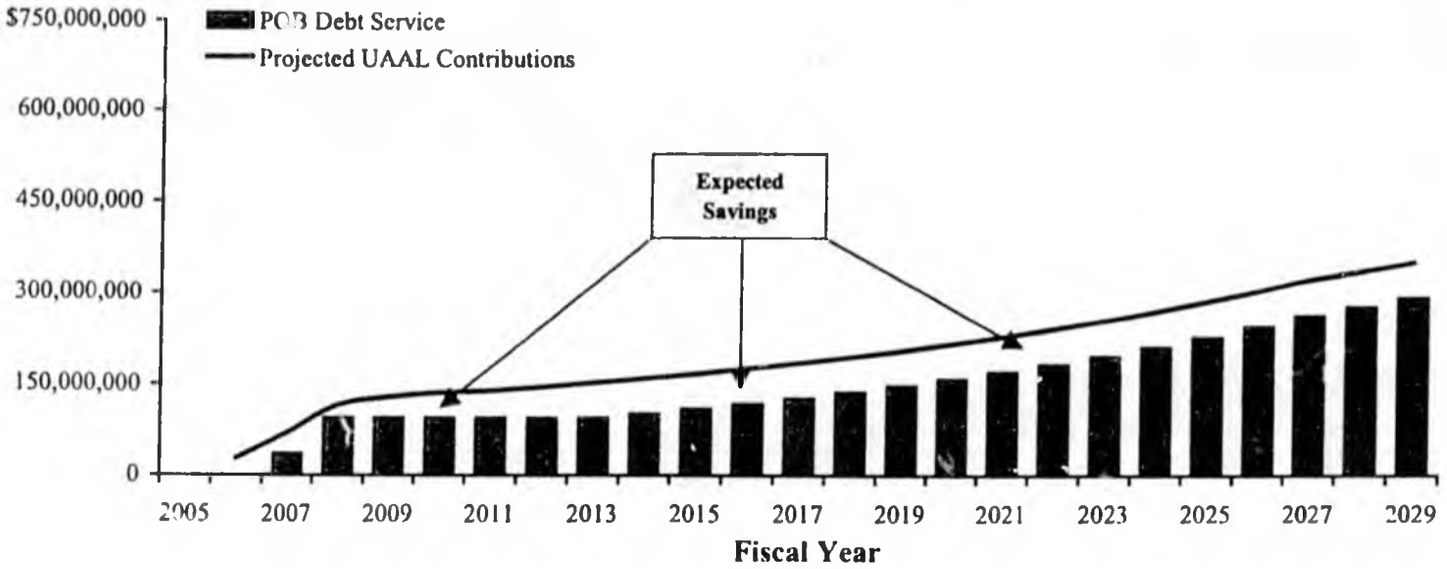


PERS Partial Funding Option —- 50% of Projected UAAL

Expected PV Savings of $477 Million

Expected Savings Summary	
All-in Bond Rate	5.19%
PV Savings (%)	25.82%
PV Savings ($)	$ 477,083,239
Gross Savings	1,241,112,285
Deposit to PERS	1,725,708,500

Expected Fiscal Savings	
FY05/06 Relief	$ 29,270,549
FY06/07 Relief	33,291,767
FY07/08 Relief	21,266,378
Total FY05-08 Relief	83,828,694
Ave. FY09-29 Relief	55,108,743

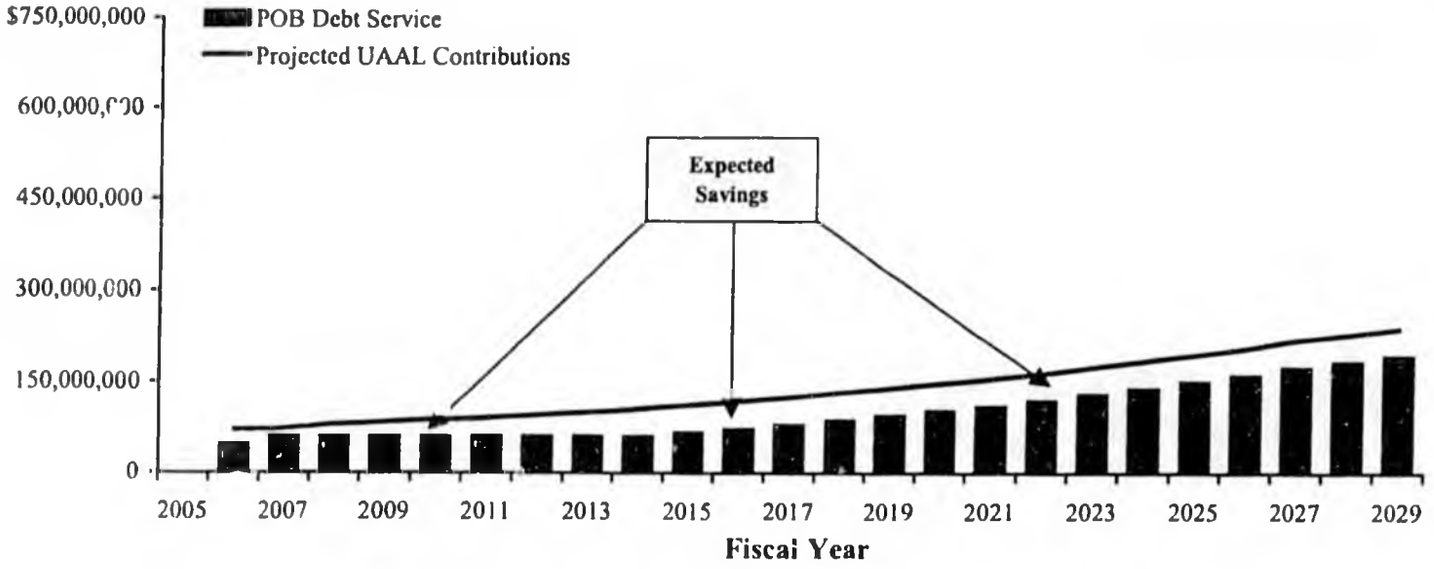


TRS Partial Funding Option — 50% of Projected UAAL

Expected PV Savings of $343 Million

Expected Savings Summary	
All-in Bond Rate	5.19%
PV Savings (%)	28.12%
PV Savings ($)	$ 342,906,079
Gross Savings	922,265,753
Deposit to PERS	1,207,373,000

Expected Fiscal Savings	
FY05/06 Relief	$ 22,414,610
FY06/07 Relief	11,809,001
FY07/08 Relief	13,877,073
Total FY05-08 Relief	52,900,884
Ave. FY09-29 Relief	41,398,337



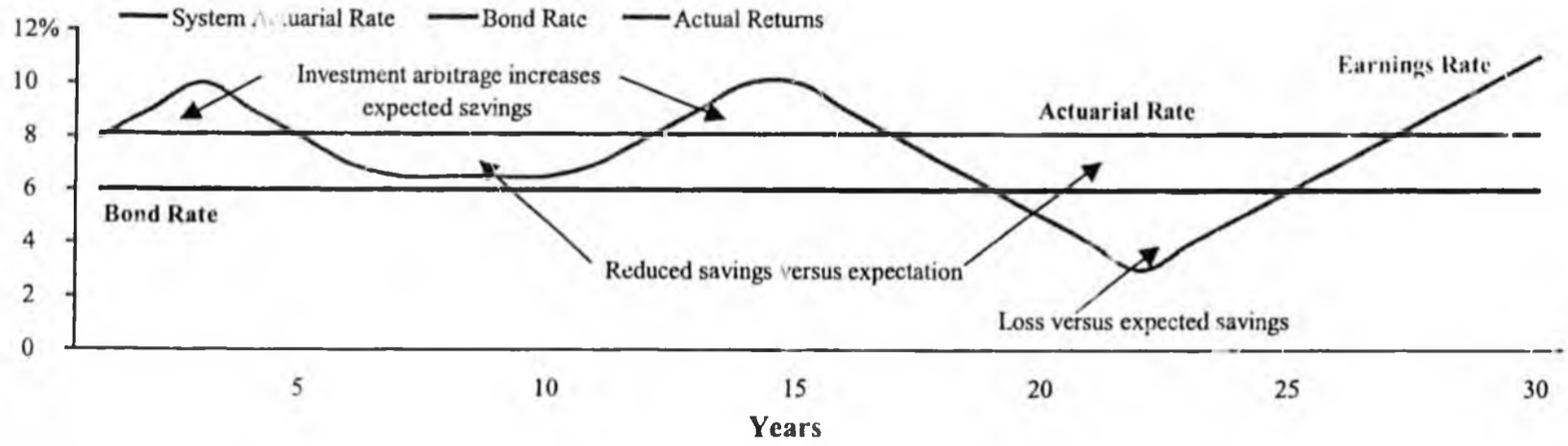
Expected Benefits of POBs

- Significant expected present value savings to meet the State's fiscal and policy objectives
  - — Generate up to $1.6 billion in expected present value savings
  - — Fully amortize UAAL within 25 years
  - — Improve financial security of PERS/TRS retirees and employees
  - — Mitigate future contribution increases
  - — Structure transaction to produce near term budgetary relief (if desired)
- Proven and acceptable tool to manage pre–existing liability
  - — Replacing a UAAL at 8.25% with a bond rate of approximately 5.20%
- Effective tool to manage/mitigate required contribution rate increases
- Statistical and probability analysis provides comfort
  - — Earnings assumptions are for a 25+ year period
  - — Historic investment management performance for PERS/TRS is strong
- Extremely favorable interest rate environment
- Bond market participants are receptive to POBs, including bond insurers, rating agencies and domestic/international institutional investors

Potential Risks of POBs

- Primary risk is failure to meet earnings expectation of actuarially assumed rate of 8.25% over life of bond deal (this "risk" currently exists with the entire asset portfolio pool)
  - — If earnings > actuarial rate: investment arbitrage increases expected savings
  - — If earnings = actuarial rate: projected savings is achieved
  - — If earnings < actuarial rate > bond rate: reduced expected savings
  - — If earnings < bond rate: dissavings

Impact of Investment Returns on Expected Savings



- Precise amount of savings is dependent upon realized rate of return over life of bond deal – not single year performance

Risk Mitigation for POBs

- Even if market returns in the early years are below the actuarial rate, it is possible to earn back the difference over the term of the transaction

8.25% Actuarial Rate Breakeven Matrix

Earnings rates required over balance of amortization period to reach expected savings

Market Returns	Years of Market Return				
	1	2	3	4	5
0.00%	8.61%	9.00%	9.43%	9.90%	10.42%
5.00%	8.39	8.54	8.70	8.88	9.08
6.00%	8.34	8.45	8.56	8.68	8.82
7.00%	8.30	8.36	8.42	8.49	8.56
8.25%	8.25	8.25	8.25	8.25	8.25
9.00%	8.22	8.19	8.15	8.11	8.06
10.00%	8.18	8.10	8.01	7.92	7.82
11.00%	8.14	8.01	7.88	7.73	7.57
12.00%	8.10	7.93	7.75	7.55	7.33

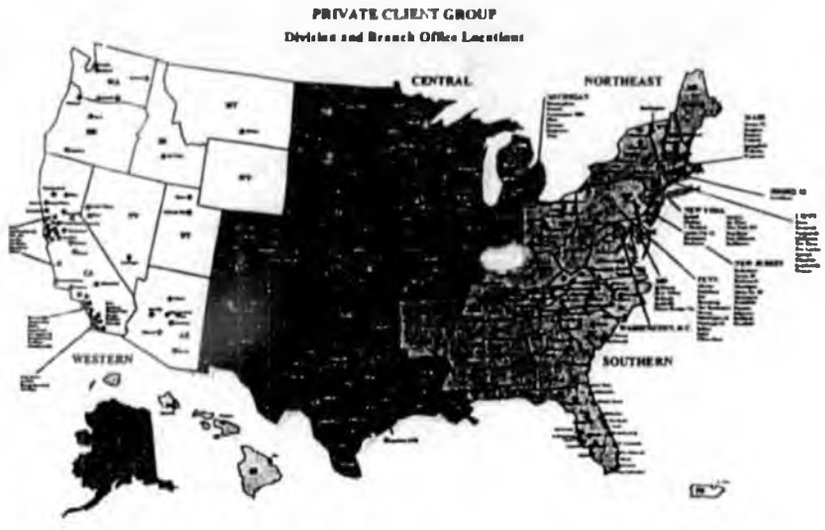
- For example, if PERS/TRS achieved a return of only 7.00% (instead of the 8.25% actuarial rate) for the first three years, then it would need to achieve an average return of 8.42% (versus 8.25%) over the remaining term of the bonds to realize the full expected savings figures

- Conversely, if earnings are above the actuarial rate in the early years, earnings in subsequent years do not need to be as high to realize projected savings, as long as funds are not diverted for other budgetary purposes

Introduction to UBS Financial Services Inc.

- UBS is one of the world's oldest, most established and stable banks
- In June 2003 UBS PaineWebber Inc. became UBS Financial Services Inc., the US retail brokerage arm of UBS AG
- UBS is a full-service national securities firm that provides comprehensive and customized solutions for our clients
- UBS Financial Services Inc.'s core business units include:
  - **Municipal Securities Group**
  - Wealth Management
  - Global Asset Management

UBS Domestic Offices



UBS

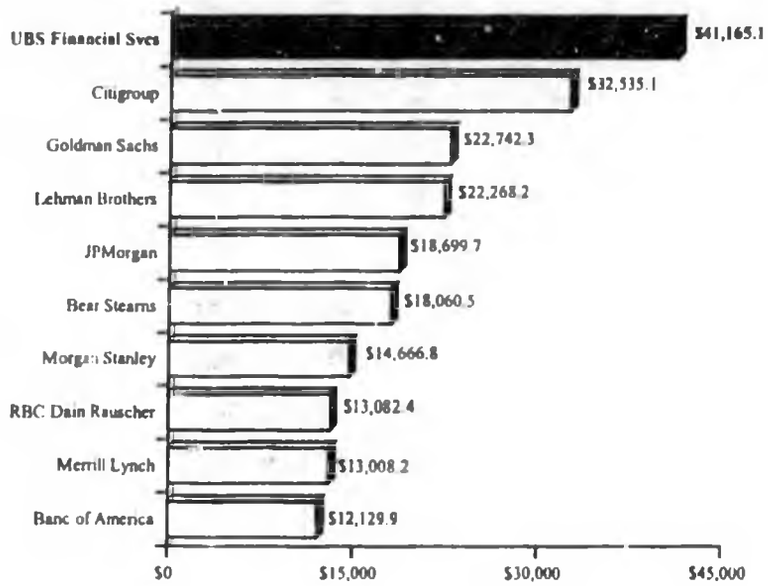
UBS Financial Services Inc.

- ✓ World's largest private bank
- ✓ Strong credit ratings (Aa2/AA+/AA+)
- ✓ Total client assets of $1.5 trillion
- ✓ Top 10 financial services firm by market capitalization ($82.3 billion)
- ✓ Leading global research platform (#3 in Europe, #3 in Asia and #4 worldwide)

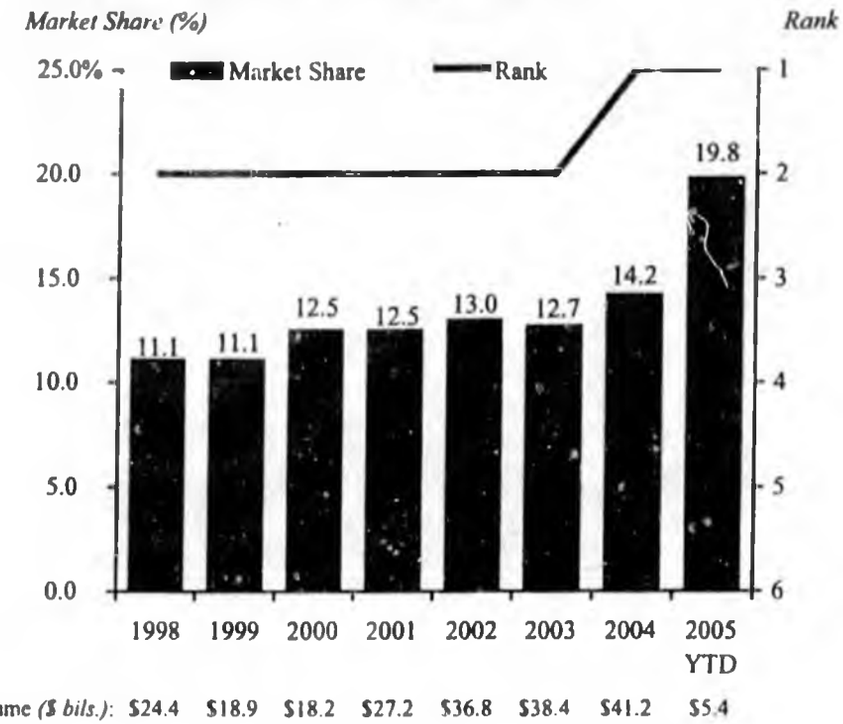
UBS's Commitment to Public Finance

2004 Senior Managed National Negotiated Rankings

($ in millions)



Senior Managed Negotiated Market Share



Volume *($ bils.)*: $24.4 $18.9 $18.2 $27.2 $36.8 $38.4 $41.2 $5.4

- UBS is the #1 ranked senior manager of municipal debt for negotiated transactions
- UBS has a demonstrated commitment to and is a dominant player in this industry

UBS's Commitment to and Presence in the State of Alaska

- For 25 years, UBS has been actively involved in over 50% of all debt issued in the State of Alaska, either as an underwriter or financial advisor
  - ✓ Senior Manager of recent State of Alaska International Airports System Bonds
    - $94,925,000 Revenue and Refunding Bonds, Series 2003A and 2003B
    - $140,780,000 Revenue Bonds, Series 2002A and 2002B
  - ✓ Senior Manager to Alaska Municipal Bond Bank Authority
    - Appointed in January 2004 for 3-5 years
  - ✓ Financial Advisor to Municipality of Anchorage
    - Broad experience since 1981
    - Advisor to $5.9 billion of Municipality's bond issues, including Anchorage General Obligation, School, Water & Wastewater, Municipal Light & Power and Telephone Utilities
- UBS is proud to be one of the few national firms to maintain a retail office in Anchorage, which services over 6,500 accounts with total assets exceeding $500 million. UBS is also an active trader of the State's bonds, with over 4,300 trades alone since 2000

Anchorage Retail Office

- 9 Financial Advisors
- Over 6,500 client accounts
- Over $509.4 million assets under management
- $1.6 million in total payroll

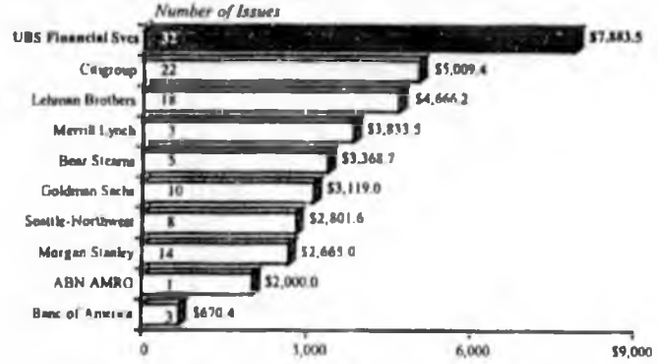
	Retail		Institutional		Total	
Year	No. of Trades	Volume ($ in 000)	No. of Trades	Volume ($ in 000)	No. of Trades	Volume ($ in 000)
2004	279	$ 17,115	34	$ 12,335	313	$ 29,450
2003	974	66,880	71	30,770	1,045	97,650
2002	1,016	92,035	40	33,370	1,056	125,405
2001	831	83,830	49	22,330	880	106,160
2000	1,013	88,699	49	56,840	1,062	145,539

UBS is the Industry Leader in Pension Obligation Bonds (POBs)

- UBS is ranked #1 in the pension obligation bond market – completing 32 issues totaling $7.88 billion or 20.0% of the POB market since 1993

UBS's Senior Managed Negotiated Pension Experience 1993 to 2004

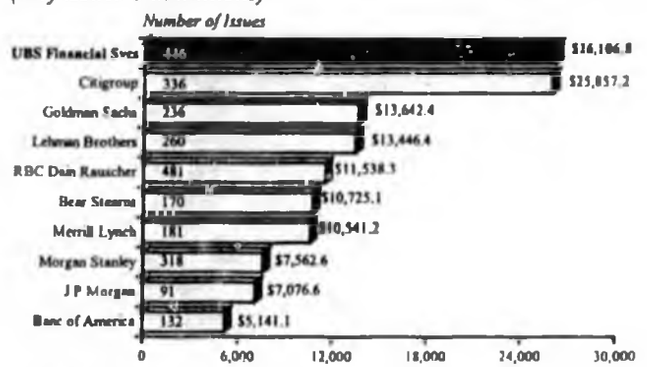
(# of issues/$ in millions)



Source: Securities Data Corporation.

UBS's Senior Managed Negotiated Taxable Experience 1993 to 2004

(# of issues/$ in millions)



Source: Securities Data Corporation.

- UBS has served as joint book-running manager for the largest and most complex POBs done to date, including the State of Illinois ($10 billion), State of Oregon ($2.1 billion) and State of Wisconsin ($1.79 billion)

- As the State's senior manager, UBS will bring all of its experience and expertise to bear on structuring the optimal solution to achieve the State's fiscal and policy objectives

UBS's POB Experience, 1993 – 2005 Selected Deals

($ in millions)

UBS Experience					UBS Placement	
Sale Date	Par Amount	Issuer	State	UBS Role	Orders Submitted by Firm	Orders Filled
10/27/04	$ 38.8	San Diego Metro Transit Dev Bd	CA	Sole Senior Mgr	38.8	38.8
10/21/04	38.7	San Diego Metro Transit Dev Bd	CA	Sole Senior Mgr	63.6	38.7
03/23/04	75.0	Fresno County	CA	Joint Book Runner	75.0	75.0
03/10/04	327.9	Fresno County	CA	Joint Book Runner	831.0	327.9
02/26/04	500.0	Kansas Development Fin Auth	KS	Senior Mgr.	489.9	250.0
12/10/03	1,794.9	Wisconsin	WI	Joint Book Runner	4,294.0	750.8
10/28/03	2,084.0	Oregon	OR	Co-Senior Manager	2,252.3	145.9
08/26/03	40.3	Kansas Development Fin Auth	KS	Senior Mgr.	72.7	36.3
06/05/03	10,000.0	Illinois [1,2]	IL	Joint Book Runner	12,317.9	148.1
05/22/03	50.0	Kern County	CA	Senior Mgr.	50.0	50.0
05/15/03	238.2	Kern County	CA	Senior Mgr	336.3	237.4
05/14/03	231.2	Sonoma County	CA	Senior Mgr	758.3	216.8
09/10/02	67.3	West Haven	CT	Sole Senior Mgr	151.3	67.3
06/26/02	90.0	Woonsocket	RI	Senior Mgr	157.4	90.0
03/13/02	117.1	Fresno County	CA	Sole Senior Mgr	136.2	117.1
02/28/02	34.0	Bangor	ME	Senior Mgr	35.7	33.6
07/18/01	111.0	Portland	ME	Sole Senior Mgr	111.0	111.0
12/18/00	170.7	New Orleans	LA	Senior Mgr	247.5	148.5
07/11/00	105.7	Fresno County	CA	Senior Mgr	124.7	94.8
01/21/99	1,291.9	Phila Auth for Indus Dev	PA	Senior Mgr	1,572.8	1,246.6
12/08/98	221.0	Worcester	MA	Senior Mgr	177.6	166.0
03/12/98	184.9	Fresno County	CA	Sole Senior Mgr	252.8	184.9
07/09/97	384.2	Denver City & Co SD #1	CO	Senior Mgr	442.1	360.9
02/14/97	436.3	Oakland	CA	Senior Mgr	476.0	342.6
11/10/95	227.8	Kern County	CA	Senior Mgr	270.0	222.7
10/07/93	19.1	Buffalo	NY	Senior Mgr	10.3	9.0
06/23/93	23.1	Buffalo	NY	Senior Mgr	16.1	12.2
01/19/05	399.3	City of Dallas	TX	Co-Mgr	5.0	3.0
06/22/04	454.1	San Diego County	CA	Co-Mgr	142.8	60.0
06/09/04	189.1	San Bernadino County	CA	Co-Mgr	59.2	49.9
06/12/03	120.0	Portland Comm Coll Dt	OR	Co-Mgr	24.0	2.2
03/14/03	90.0	Gainesville	FL	Co-Mgr	42.8	15.0
03/07/03	375.0	NJ Economic Dev Auth	NJ	Co-Mgr	75.0	3.9
09/17/02	737.3	San Diego County	CA	Co-Mgr	147.5	11.7
08/22/00	350.0	Bridgeport	CT	Co-Mgr	152.3	48.5
02/03/99	63.1	Merced County	CA	Co-Mgr	12.6	0.7
06/26/97	2,803.0	NJ Economic Dev Auth	NJ	Co-Mgr	560.6	51.5
11/01/96	773.5	NYS Dorm Authority	NY	Co-Mgr	154.7	14.1
10/19/95	600.0	Los Angeles County	CA	Co-Mgr	120.0	6.6
10/13/94	1,965.2	Los Angeles County	CA	Co-Mgr	393.0	36.4
09/23/94	320.0	Orange County	CA	Co-Mgr	64.0	5.8
02/03/94	430.4	San Diego County	CA	Co-Mgr	86.1	4.7
	$ 18,903.1	Senior Managed				
	$ 9,270.7	Co-Managed				
	$ 28,173.8	Total				

(1) UBS and Bear Stearns were Joint Book-Running Managers. There were three additional co-senior managers and SDC credit was split equally among the five.
(2) The State of Illinois transaction with the exception of one maturity was sold group net.

Current POB Market Update

- POBs are a commonly used financial tool to improve the funding levels of state and local pension systems. Since 1993, there have been over 350 POB issues totaling $40.3 billion
- POBs are interest rate sensitive and many issuers are proactively considering POBs to lock-in current interest rates and expected savings figures
- If interest rates rise (as forecasted), the expected savings from a POB transaction will diminish or even disappear

UBS's Recently Priced POBs:

Kern County, California	State of Illinois	State of Oregon	State of Wisconsin	Kansas Development Finance Authority	Fresno County, California
$238,177,000 Senior Book Running Manager May 15, 2003	$10,000,000,000 Joint Book Running Manager June 5, 2003	$2,083,960,000 Co-Senior Manager October 28, 2003	$1,794,850,000 Joint Book Running Manager December 10, 2003	$500,000,000 Senior Book Running Manager February 26, 2004	$327,898,000 Joint Book Running Manager March 10, 2004

Next Steps — POB Strategy and Implementation

- Limited window of opportunity due to potential increased rates
- General education of interested parties
- Policy analysis of use of expected savings and debt structure
- Drafting of enabling legislation to provide opportunity for State to take advantage of expected cost savings
- Legislative authorization and action
- Confirmation of existing pension fund data, assumptions and paydown schedule
- Determination of appropriate annual contribution rate for the State
- Deal specific decision-making

APPENDIX

Alaska's UBS Banking Team

Investment Banking

JAMES W. ZIGLAR, Sr.
Managing Director & Chief Business Strategist

Mr. Ziglar joined UBS as a Managing Director and Chief Business Strategist for the Municipal Securities Group on June 1, 2004. Mr. Ziglar has 23 years of experience in the public finance business as an investment banker and lawyer, including over 10 years with UBS prior to departing in 1998 to serve as Sergeant at Arms of the United States Senate. Most recently, Mr. Ziglar was Distinguished Visiting Professor of Law at George Washington University Law School and a Fellow at Harvard University's John F. Kennedy School of Government Institute of Politics. He was Commissioner of the Immigration and Naturalization Service from August 2001 until his retirement from federal service in November 2002. In addition to his positions as Commissioner of the INS and as Sergeant at Arms of the United States Senate, he has served at various times as Assistant Secretary of the Interior for Water and Science - where he oversaw the operations of the Bureau of Reclamation, the Bureau of Mines and the U.S. Geological Survey, as a law clerk to Supreme Court Associate Justice Harry A. Blackmun, as a congressional and public affairs officer at the Department of Justice, and as an aide to the Chairman of the U.S. Senate Judiciary Committee.

Mr. Ziglar earned his undergraduate and law degrees from The George Washington University. He is a member of the bar in New York, Arizona, Virginia and the District of Columbia.

JOHN COSTAGLIOLA
Managing Director & Manager of West Coast Infrastructure

John Costagliola has 19 years of experience in public finance and leads the Firm's efforts in Alaska. Mr. Costagliola has served as the Financial Advisor to the Municipality of Anchorage since 1993, and senior managed bond issues within the State for the Airport system, Bond Bank Authority and AIDEA. Mr. Costagliola is in frequent dialogues with rating agencies on Alaska issues and credit concerns. Mr. Costagliola has very broad experience with electric utilities, water and sewer systems, general government finance and credit issues. He joined UBS in 1993 after seven years with Standard and Poor's Corporation where he was a Director and manager of their utility group in the Western Regional Office. While at S&P, Mr. Costagliola was principal analyst and chaired numerous rating committees within all public finance sectors. He has a Bachelor's degree from Fordham University and is an MSRB principal.

Alaska's UBS Banking Team

ROBERT DOHERTY
Managing Director & Co-Head National Infrastructure Group

Mr. Doherty has over 18 years of banking experience. He recently joined UBS from Merrill Lynch, where his responsibilities included managing the Firm's geographic banking relationships in the Midwest, South and East Coast. Mr. Doherty was also responsible for the Firm's pension obligation bond group and served as the lead banker for the State of New Jersey's $2.8 billion pension obligation bond transaction – the largest municipal transaction then executed. The State of New Jersey's POB financing was named "Deal of the Year" by Smith's Survey. At UBS, Mr. Doherty has served as the lead banker for several senior managed POBs, including the State of Kansas' $500 million issue and State of Wisconsin's $1.8 billion issue which was named "Midwest Deal of the Year" by The Bond Buyer. Mr. Doherty is currently working on senior managed POB transactions for the City of Detroit ($1.3 billion) and the City of San Antonio ($350 million). Mr. Doherty also served as the lead banker for the States of Wisconsin, Ohio, Kentucky, New Jersey, Michigan and Massachusetts on numerous transactions. He has significant banking experience designing customized financial solutions for clients.

Mr. Doherty received his MBA from the University of Chicago and his undergraduate degree in international politics from Georgetown University's School of Foreign Service.

TOM YANG
First Vice President

Tom Yang is a member of UBS' Transportation Finance Group. He currently manages our West Coast transportation and airport efforts. Mr. Yang is an expert on structuring bond financings secured by innovative transit credits such as the Congestion Mitigation and Air Quality funds, FTA's Section 5307 formula funds and Section 5309 New Starts funds, congestion mitigation and air quality funds, farebox revenues and state transportation grant funds. He recently served as the senior banker on a $77 million pension obligation bond issue for San Diego Transit Corporation, the first pension obligation bond financing completed for a transit agency.

Mr. Yang also served as the day-to-day banker for two recent financings for Alaska International Airports System. His senior managed bond issues in the past 24 months include Los Angeles County Metropolitan Transportation Authority, San Francisco Airport Commission, Burbank Airport Authority, San Diego Metropolitan Transit Development Board, Sacramento Regional Transit District, North San Diego County Transit District, Boise Airport and Riverside Transit Agency.

Mr. Yang graduated with High Honors from the University of California, Berkeley with a degree in Mechanical Engineering.

Alaska's UBS Banking Team

BRYANT JENKINS
Assistant Vice President

Mr. Jenkins has over 6 years of public finance experience and has provided quantitative analysis and transaction support for over $7.3 billion in senior managed financings for clients including pension obligation bonds for the State of Illinois, Kansas Development Finance Authority, San Diego Metropolitan Transit Development Board and the State of Oregon. His experience also includes working with Alaska issuers including the Alaska Municipal Bond Bank and the Municipality of Anchorage.

Mr. Jenkins received his B.A. in Economics from Columbia University and M.B.A. from Stanford University.

MARK T. KIM
Assistant Vice President

Mr. Kim joined UBS in 2002 and is a member of the firm's National Infrastructure Group. Mr. Kim's experience includes structuring multiple senior managed transactions totaling over $3.0 billion. These transactions include $1.2 billion (including a $587 million swaption) for the Long Island Power Authority (LIPA) in connection with a major restructuring program. More recently, Mr. Kim has focused on structuring pension obligation bond issues and other taxable transactions for clients at the state and local level, including the State of Wisconsin's $1.8 billion POB, which was awarded the Bond Buyer's "Midwest Deal of the Year" award. Prior to joining UBS, Mr. Kim served as a Staff Attorney for the Federal Election Commission (FEC) in Washington, D.C.

Mr. Kim received his Ph.D. in Public Policy from Harvard University; J.D. in Public Law from Cornell Law School; and B.A. in Philosophy from Northwestern University. Mr. Kim is a member of the Bars of the District of Columbia and the State of New York.

Alaska's UBS Banking Team

Underwriting

STEVE M. PILLER
Director

Mr. Piller has 20 years experience in the municipal securities industry. As a Director in UBS's Syndicate Department, he is responsible for the underwriting and marketing of municipal transactions, including negotiated and competitive underwritings, both tax-exempt and taxable.

In addition to developing marketing strategies for municipal issues in the primary market, Mr. Piller coordinates the distribution process with the client and bankers. This includes identifying buyers, working closely with the retail and institutional sales divisions and apprising the client of market conditions and economic developments that could affect interest rate levels. Mr. Piller also coordinates the trading and marketing of secondary risk positions for new issues. Mr. Piller attended York College.

Derivative Products

RHAHIME A. BELL
Managing Director

Rhahime Bell, Co-head of the Municipal Derivatives Group, joined UBS in May, 1999. Prior to joining UBS, Mr. Bell was a Vice-President in the Global Derivatives Group at J.P. Morgan. Most recently, Mr. Bell was responsible for advising corporations and government entities in Latin America on interest rate and currency risk management. Prior to his work in Latin America, Mr. Bell was responsible for marketing tax-exempt derivatives to municipalities within the United States. Mr. Bell negotiated and executed over 700 interest rate swap, options and forward purchase agreements during 1993 and 1998. In addition, Mr. Bell was responsible for trading and risk management of the TBMA/LIBOR basis position for J.P. Morgan. Mr. Bell graduated from Georgetown University in 1991 with a dual degree in Finance and International Management.

Alaska's UBS Banking Team

Municipal Research

BRAD GEWEHR
Managing Director

Mr. Gewehr joined UBS in March 1998 as Director of Municipal Research. In addition to providing research for UBS's retail and institutional investors, Mr. Gewehr and his staff have assisted many of UBS's banking clients in developing effective credit rating and investor relations strategies. Immediately prior to joining UBS, Mr. Gewehr was a Managing Director in the Public Finance Group of Moody's Investors Service. He supervised a staff of analysts responsible for assigned and maintaining ratings on municipal tax–backed, utility revenue, and lease credits in 26 states, including California, New York, Florida, and Illinois. As a senior member of Rating Committee, he participated in rating decisions for major credits throughout the United States. Brad also led analytical specialty teams covering the water and wastewater and state revolving fund sectors.

Prior to joining Moody's in 1991, Mr. Gewehr was a Project Manager and Transportation Analyst with the Port Authority of NY & NJ. He holds an MBA in Finance from New York University and a BA from Amherst College.

UBS's POB Structuring Methodology

Step 1: Determine the Dollar Value of the UAAL

- Asset valuation (e.g., actuarial, mark to market, etc.)
- Present value of future liabilities

UAAL = Liabilities – Assets

Step 2: Determine the Existing UAAL Payment Schedule

- Number of years or amortization period
- Amortization method (e.g., level percentage of payroll, statutorily determined, etc.)
- Actuarial assumptions (e.g., covered payroll, annual pay increase, etc.)
- State portion of UAAL
- GASB Note 25 and 45 considerations

UAAL Payment = Covered Payroll x UAAL Contribution Rate

UBS's POB Structuring Methodology

Step 3: Structure POBs against UAAL Payment Schedule

- Understand PERS/TRS's fiscal and policy objectives (e.g., immediate cashflow relief, level savings, etc.)

- Structure bonds to help achieve PERS/TRS's objectives by:
  - — Principal Deferral
  - — Income Bonds
  - — Stepped Coupon Bonds
  - — Capitalized Appreciation Bonds ("CABs")
  - — Capitalized Interest Fund

- Derivative Products (e.g., synthetic fixed, step coupons, etc.)

- Calculate Expected Savings

Expected Savings = Existing UAAL Payment – POB Debt Service

POB Case Studies

Customized Solutions for Our POB Clients

- UBS's senior managed POB experience encompasses issuers at the State, City, County and System levels and includes a variety of innovative credit and financing structures designed to help our clients meet their financial and policy objectives

- Given an issuer's specific situation, UBS has consistently created unique marketing plans, rating agency presentations, legislative strategies, financial tools and deal structures that have helped our clients realize their goals

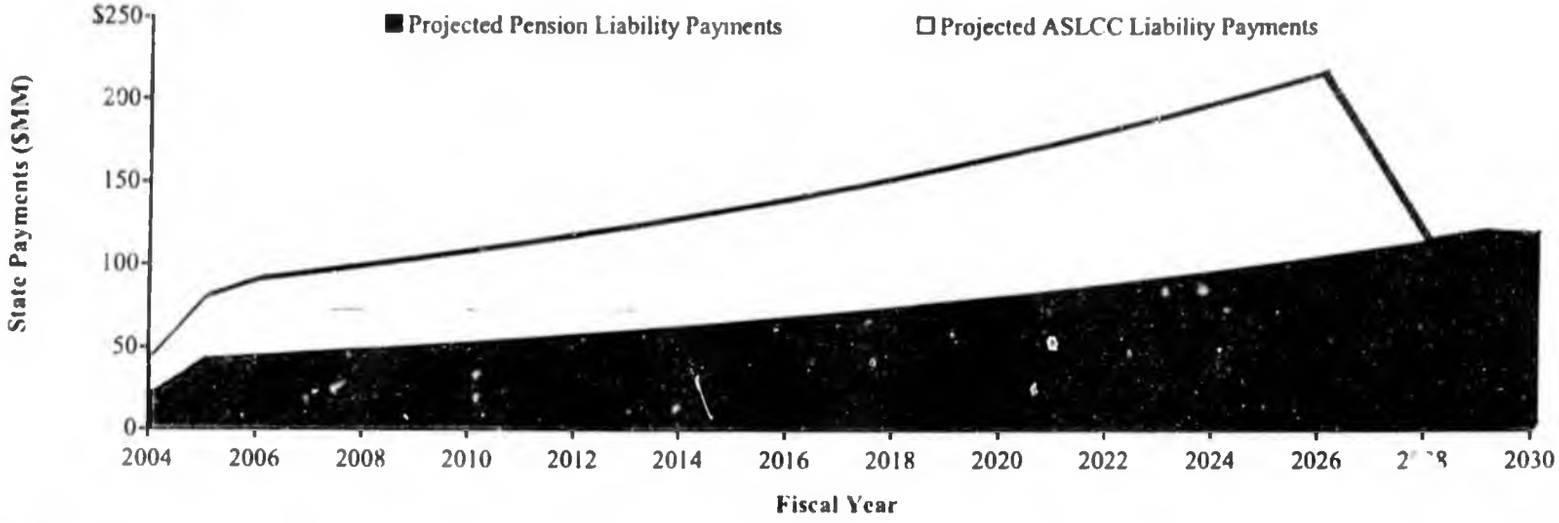
- Below are highlights of several challenges that our clients have faced and the customized solutions that UBS created as senior manager

Transaction	Challenge	Solution
Philadelphia, PA	Special legislation required; needed budget relief over 10-year period; pension system severely underfunded	Legislation passed to allow for conduit issuer – still obtained BIS weighting of 20%; funded 50% of UAAL; extensive use of CABs to structure debt to meet revenue requirements; income bonds to provide call flexibility; all-in cost of 6.63% vs. 9.00% actuarial rate
Portland, ME	Very steep UAAL payment curve; savings targets for implementation of deal	Tailored savings through "synthetic" stepped coupon bond; saved 32 basis points versus natural structure
Denver Public Schools, CO	Lease appropriation credit with school property as collateral; desired savings over time; pension solution needed for labor negotiations	Devised "proportional" savings structure; structured term bond with 10-year 102% call feature; obtained aggressive insurance commitment; 7.19% TIC versus deal target of 7.40% and actuarial rate of 8.50%
Oakland, CA	Only allowed for 15-year transaction; severely underfunded system; weak credit	"Prepaid" first 15 years of amortization through contract with System; extensive use of CABs; aggressive insurance commitment

Case Study: The State of Wisconsin's $1.794 Billion POB

Background

- UBS served as joint book running manager for the State of Wisconsin's $1,794,850,000 General Fund Annual Appropriation Bonds of 2003, $850 million Series A (Taxable Fixed Rate) and $945 million Series B (Taxable Auction Rate Certificates)
- The State sold bonds to retire the Unfunded Pension and ASLCC Liabilities owed to the Wisconsin Retirement System ("WRS") and lower its financing cost from 8% to the bond rate
- Bonds were structured against the combination of the State's projected pension liability and ASLCC liability payments shown below as the "red line"



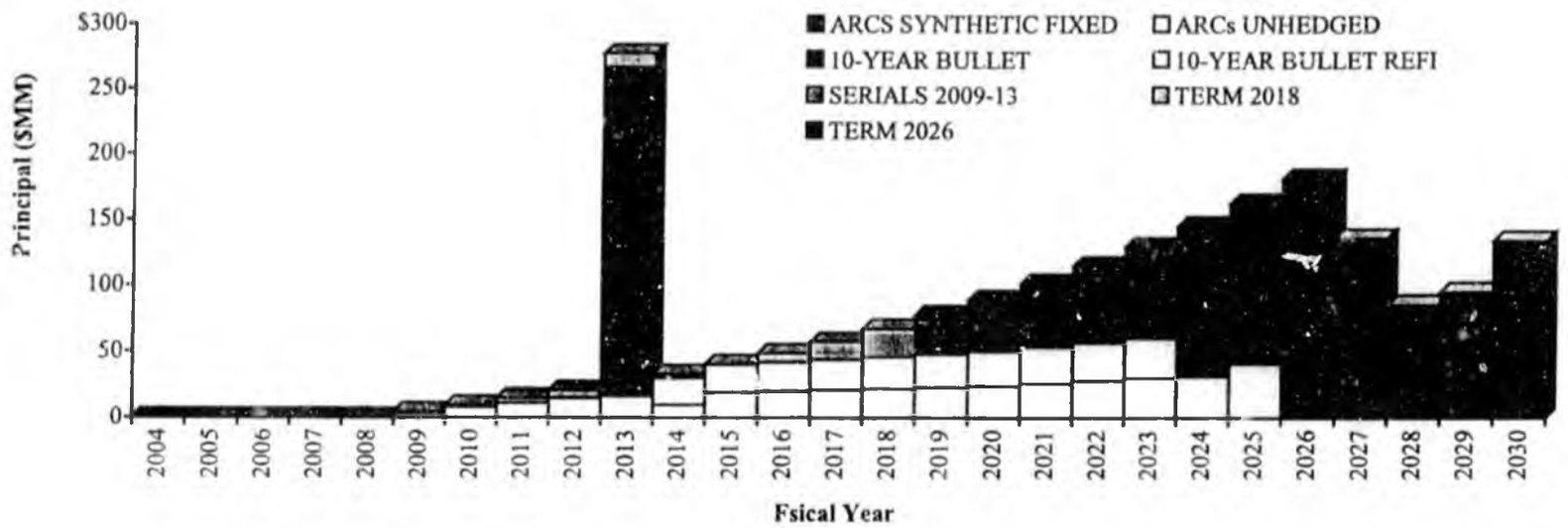
Case Study: The State of Wisconsin's $1.794 Billion POB

Structure

Series A – 10 Year Bullet	$ 250,000,000
Series A – Term Bond 2018	100,000,000
Series A – Term Bond 2026	500,000,000
Series A - Total	**$ 850,000,000**
Series B – ARCs Unhedged (assumed rate of 5.59%)	$ 349,700,000
Series B – ARC Synthetically Fixed	595,150,000
Series B – Total	**$ 944,850,000**
TOTAL GFAAB Issue	**$ 1,794,850,000**

Ratings

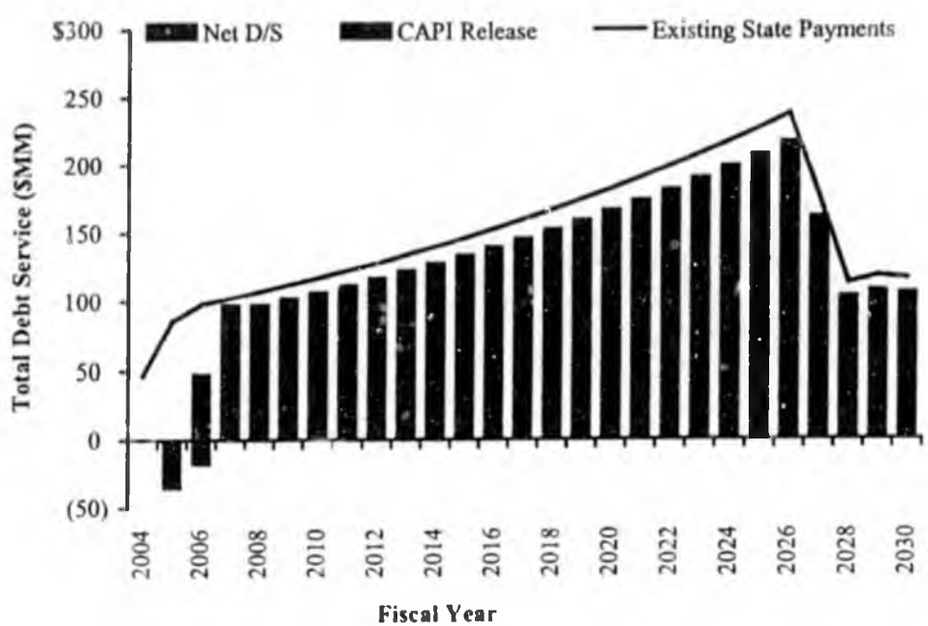
Unenhanced	A1/A+/AA-
Enhanced	Aaa/AAA/AAA
Corporate Equivalent:	Aa1
Credit:	General Fund Annual Appropriation Bonds of 2003
Pricing Date:	12/10/2003
Dated Date:	12/18/2003
Call Feature:	Make-Whole Call 2014 at Treasury Rate plus 12.5 bps



Case Study: The State of Wisconsin's $1.794 Billion POB

Benefits

- The State was able to fully fund its accrued pension and sick leave liabilities
- The transaction generated substantial expected PV savings of over $323 million or 22%
- The State realized immediate cash flow savings and significant budgetary relief
- An all-in true interest cost of 5.804% for the entire transaction (assumes unhedged ARCs at 5.59%)
- The State reduced its overall financing costs by executed its first synthetic fixed rate swap of $595 million with an all-in swap rate of 5.47% (average life 25.24 years)
- First issuance of ARCs issued at an initial rate of 1.20% offer future financial flexibility



Case Study: The State of Wisconsin's $1.794 Billion POB

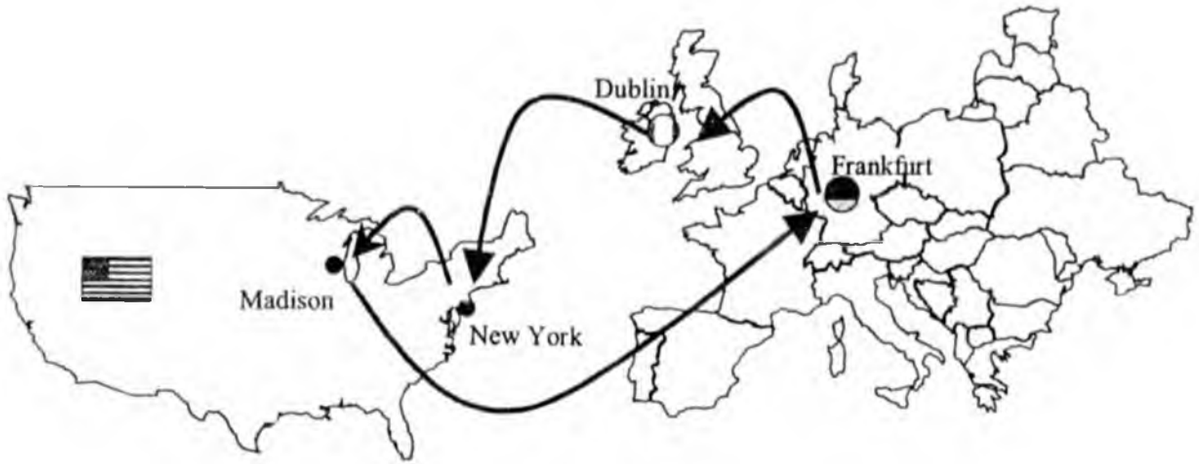
Credit and Call Features

- The bonds are backed by State appropriations as part of the General Fund Annual Appropriation Bond credit; a new credit, which UBS help the State inaugurate. The key security features include:
  - -- Moral Obligation
  - – High Priority Payment Status
  - — Continuing Budget Authority
  - — Appropriation Mechanism
  - — Stabilization Fund
  - — Cashflow/Debt Management Techniques
  - — Bond Insurance
- Underlying ratings of (A1/A+/AA-) with a Moody's corporate equivalent rating of (Aa1)
- The entire issue was insured: Series A by FSA and Series B by XL Capital Assurance
- A $32.935 million Stabilization Fund was established to protect against rising interest rates associated with the unhedged ARCs and which serve as additional security for the issue
- The structure included a $250 million, non-callable, 10-year bullet. The State expects to refinance this entire amount in on or before 2013 with additional bonds that have already been authorized under the Indenture
- Two term bonds (2018 and 2026) have an optional, make-whole call provision
- Issue included nine subseries of ARCs totaling $350 million, which provides the state with significant financial flexibility

Case Study: The State of Wisconsin's $1.794 Billion POB

Marketing

- UBS managed a global offering plan. Clearance through DTC, Euroclear, and Clearstream. The Bonds are listed on the Luxembourg Stock Exchange
- UBS coordinated and helped present at an International Roadshow, which included meetings in the United States, Germany and Ireland
- In addition to UBS's domestic capabilities, UBS's global sales force helped set up in-person meetings with 17 institutional investors in Europe and UBS's global roadshow coordinator helped ensure flawless meeting arrangement for the State and UBS bankers
- UBS scripted and recorded a Bloomberg Electronic Roadshow for institutional investors in all market segments to use in considering the Bonds



Case Study: The State of Illinois' $10 Billion POB

$10,000,000,000
State of Illinois
General Obligation Bonds
Pension Funding Series of June 2003 (Taxable)

RATINGS	**Moody's Corporate Equivalent**	**Municipal**	**S&P**	**Fitch Ratings**
	Aa3	Aa3	AA	AA
RELEVANT DATES	**Pricing**	**Dated**	**Delivery**	**First Interest**
	June 5, 2003	June 12, 2003	June 12, 2003	Dec 1, 2003

OPTIONAL REDEMPTION None
TAX STATUS Taxable
PUBLICLY OFFERED United States, Europe and Asia
LISTED Luxembourg Stock Exchange
GLOBAL BOOK ENTRY DTC, Clearstream and Euroclear

AMORTIZATION

Date	Principal	Sinking Fund	Coupon	Yield	Price	Benchmark	Yield	Spread
June 1, 2008	50,000,000		2.500	2.522	99.897	5 Yr. Note	2.222	30 bps
June 1, 2009	50,000,000		2.800	2.822	99.879	5 Yr. Note	2.222	60 bps
June 1, 2010	50,000,000		3.300	3.324	99.851	10 Yr. Note	3.324	0 bps
June 1, 2011	50,000,000		3.550	3.574	99.833	10 Yr. Note	3.324	25 bps
June 1, 2012	100,000,000		3.750	3.754	99.968	10 Yr. Note	3.324	43 bps
June 1, 2013	100,000,000		3.850	3.874	99.802	10 Yr. Note	3.324	55 bps
June 1, 2014	100,000,000		3.950	3.974	99.787	10 Yr. Note	3.324	65 bps
June 1, 2015	100,000,000		4.050	4.074	99.773	10 Yr. Note	3.324	75 bps
June 1, 2016		100,000,000						
June 1, 2017		125,000,000						
June 1, 2018	375,000,000	150,000,000	4.350	4.354	99.955	10 Yr. Note	3.324	103 bps
June 1, 2019		175,000,000						
June 1, 2020		225,000,000						
June 1, 2021		275,000,000						
June 1, 2022		325,000,000						
June 1, 2023	1,375,000,000	375,000,000	4.950	4.960	99.872	30 Yr. Bond	4.380	58 bps
June 1, 2024		450,000,000						
June 1, 2025		525,000,000						
June 1, 2026		575,000,000						
June 1, 2027		625,000,000						
June 1, 2028		700,000,000						
June 1, 2029		775,000,000						
June 1, 2030		875,000,000						
June 1, 2031		975,000,000						
June 1, 2032		1,050,000,000						
June 1, 2033	7,650,000,000	1,100,000,000	5.100	5.100	100.000	30 Yr. Bond	4.380	72 bps

Case Study: The State of Illinois' $10 Billion POB

$10,000,000,000
State of Illinois
General Obligation Bonds
Pension Funding Series of June 2003 (Taxable)

SECURITY	General Obligation of the State of Illinois
PURPOSE	The net proceeds of the Bonds will be used to (i) reimburse the State's General Revenue Fund for a portion of the contributions made to the Retirement Systems for the last quarter of the State's fiscal year 2003, (ii) reimburse the State's General Revenue Fund for the State's contributions to the Retirement Systems for the State's fiscal year 2004, (iii) fund a portion of the unfunded accrued actuarial liability ("UAAL") contribution representing pension benefits earned in prior years and (iv) pay other costs including capitalized interest and costs of issuance.
AUTHORITY FOR ISSUANCE	The Bond Act, as amended by Public Act 93-2, which became effective as of April 7, 2003, empowers the State to issue and sell up to $10 billion of general obligation bonds of the State, including the Bonds, for the purpose of funding or reimbursing a portion of the State's contributions to the following retirement systems: the State Employees' Retirement System of Illinois, the Teachers' Retirement System of the State of Illinois, the State Universities Retirement System, the Judges Retirement System of Illinois, and the General Assembly Retirement System. In addition to the GO Pension Funding Bonds, the Bond Act authorizes the State to issue and sell direct, general obligations of the State, in the aggregate amount of approximately $17.7 billion (excluding refunding bonds).
STATE OF ILLINOIS RETIREMENT SYSTEMS	Pursuant to the Illinois Pension Code, as amended, the State is responsible for funding employer contributions of the Retirement Systems. The State currently makes payments to the Retirement Systems on an annual basis, consisting of (i) unfunded accrued actuarial liability, and (ii) a contribution representing the State's obligation for its share of the costs of various current benefits. As of June 30, 2002 (the most recently completed fiscal year of the State), the Retirement Systems had an aggregate membership of 311,707 active members, 168,341 inactive members entitled to benefits and 147,956 retired members and beneficiaries. As of June 30, 2002, based upon the most recent available actuarial valuation of the Retirement Systems, the actuarially determined accrued liabilities of the Retirement Systems were approximately $75.2 billion, the fair market value of their assets was approximately $40.3 billion, and the aggregate UAAL with respect to the Retirement Systems was approximately $34.9 billion.
ROADSHOW	

- Transaction was considered a full public offering in the United States, Europe and Asia
- There were certain restrictions in certain countries (e.g., United Kingdom, France, the Netherlands, Singapore and Japan) similar to U.S. Blue Sky laws

Case Study: The State of Illinois' $10 Billion POB

$10,000,000,000
State of Illinois
General Obligation Bonds
Pension Funding Series of June 2003 (Taxable)

TIMETABLE

Date	Activity
Wednesday, 5/21/2003	POS Distributed Electronically
Thursday, 5/22/2003	POS Distributed in Hard Copy
	Bloomberg Roadshow
Week of 5/26	Ratings Received
Thursday, 5/29/2003	Structure Wire Released to Syndicate
Friday, 5/30/2003	Call with State to Discuss Execution Detail
	Call with Syndicate to Discuss Schedule/Process
Tuesday, 6/3/2003	Price Views Solicited from Management Team
	Price Views Distributed to State
	Final Sign Off from the State on Price Guidance
	Call with Joint Leads to Discuss Price
	Deal Announced (Official Price Guidance), Books Opened for Indications
Wednesday, 6/4/2003	Close Book
	Call with State to Discuss Order Book
	Launch Transaction with Any Size, Structure or Pricing Adjustments (Final Price Talk) (Verbal Award)
	Complete Allocation Process
Thursday, 6/5/2003	Give Allocations to Investors
	Determine UST's Sales Against Customer Allocations
	Price Transaction (Final Price)
	Sign BPA
Monday, 6/9/2003	Mail Final OS
Thursday, 6/12/2003	Settlement

MARKETING

Maturity	Principal	UBS Orders	Total Orders	UBS % of Total
June 1, 2008	50,000,000	29,950,000	118,205,000	25.3%
June 1, 2009	50,000,000	2,500,000	20,000,000	12.5%
June 1, 2010	50,000,000	229,500,000	879,500,000	26.1%
June 1, 2011	50,000,000	277,500,000	999,250,000	27.8%
June 1, 2012	100,000,000	411,500,000	1,471,500,000	28.0%
June 1, 2013	100,000,000	376,550,000	1,068,340,000	35.2%
June 1, 2014	100,000,000	219,000,000	357,000,000	61.3%
June 1, 2015	100,000,000	271,000,000	523,400,000	51.8%
June 1, 2018	375,000,000	270,000,000	646,225,000	41.8%
June 1, 2023	1,375,000,000	3,091,285,000	9,751,220,000	31.7%
June 1, 2033	7,650,000,000	8,580,300,000	20,256,650,000	42.4%
	10,000,000,000	**13,759,085,000**	**36,091,270,000**	**38.1%**

Case Study: The State of Illinois' $10 Billion POB

$10,000,000,000
State of Illinois
General Obligation Bonds
Pension Funding Series of June 2003 (Taxable)

SYNDICATE

Role	Name
Joint Book-Running Manager	Bear Stearns
Joint Book-Running Manager	**UBS Financial Services Inc.**
Co-Senior Manager	ABN AMRO
Co-Senior Manager	Citigroup
Co-Senior Manager	Goldman Sachs
Co-Manager (Group 1)	Loop Capital Markets
Co-Manager (Group 1)	Merrill Lynch
Co-Manager (Group 1)	RBC Dain Rauscher
Co-Manager (Group 1)	Ramirez & Co.
Co-Manager (Group 1)	Siebert Branford Shank & Co.
Co-Manager (Group 2)	Apex Pryor Securities
Co-Manager (Group 2)	Cabrera Capital Markets
Co-Manager (Group 2)	First Midstate Inc.
Co-Manager (Group 2)	Melvin Securities
Co-Manager (Group 2)	SBK-Brooks Investment Corp.
Co-Manager (Group 2)	Wachovia Bank, N.A.

POB Disclaimer

The projected savings contained in this analysis are reflective of various structuring, bond, and interest rate assumptions as well as forward looking actuarial assumptions regarding the Public Employees' and Teachers' Retirement Systems.

The expected savings shown are contingent upon a consistent assumed annual rate of return of investments for PERS/TRS over the life of the bond deal, among other assumptions. In addition, UBS has incorporated an assumed unfunded actuarial accrued liabilities (UAAL) paydown schedule that was obtained and/or derived from credible, publicly available sources, upon which expected savings are calculated.

Changes in PERS/TRS's underlying assumptions, including but not limited to, mortality, salary, amortization method, actuarial cost method, asset valuation method, payroll increase, statutory UAAL contribution rates, benefits levels, cost-of-living adjustments (COLAs), term of UAAL amortization as well as the effects of "income smoothing," will have either a positive or negative effect on any future funding deficits or surpluses.

There is no guarantee that any projected savings will be realized, nor that PERS/TRS will not accrue a new UAAL after the issuance of the bonds, even if the portfolio of investments earns the expected actuarial rate of return and the expected UAAL paydown schedule is realized for the life of the bond deal.

Please consult your financial advisor and/or actuary regarding these issues and risks.

Tape Log for Tapes 1 and 2

Tape No.	Speaker	Subject

January 12-13, 2006
Juneau, Alaska
Goldbelt Hotel, Egan Drive

ALASKA RETIREMENT MANAGEMENT BOARD (WORK SESSION) MEETING

ARM BOARD MEMBERS present: Martin Pihl, Gail Schubert, William Corbus, Sam Trivette, Gayle Harbo, Scott Nordstrand, Larry Semmens, Michael Williams

ARM BOARD MEMBERS absent: John Roses

STATE REVENUE STAFF: Gary Bader (CIO), Judy Hall, Bob Mitchell, Tom Boutin, Susan Taylor
ADMIN and R&B STAFF: Melanie Millhorn, Traci Carpenter, Kevin Brooks

IAC MEMBERS PRESENT: Dr. Jerrold Mitchell, Dr. William Jennings

OTHERS PRESENT: Rob Johnson (outside legal counsel); Michael O'Leary, Callan Associates; Clark Gruening, Don Gottschall, Michael Kirk, Chester Johnson (State Financial Advisor), Cynthia Weed (State bond counsel), Jeffrey Sinz (Municipality of Anchorage); Kevin Richie (AK Municipal League); Mike Barnhill (AG's Office); Don Gotschall; Kristin Erchinger (City of Seward); Derek Miller (Rep. Kelly Aide); Jack Kreinheder (OMB); Cindy Spanyers (APEA/AFT); Donn Stewart (DOA Personnel)

Tape 1, Side A
Thursday, January 12, 2006

Start Time: 9:00 a.m.

0	Roll call		Harbo, Nord, Pihl, Schubert, Semmens, Trivette, Williams.
			Public meeting notice rqmt. met
			Agenda
			Harbo motion, Semmens 2nd.
	Trivette		Letter to add.
	Schubert		Approved.
			Public Appearances.
1	Michael Kirk	✓	Ret 20 yrs from teaching. I first brought to actuary's attn that assumptions are from 1930s. Longevity - how long to work, how much they contribute, how long they benefit. "Nothing comes from nothing." Experience nationally shows I did know what I was talking about. "From many comes one." Many contribute to my retirement? Make it fit.
6	Schubert		**Minutes.**
	Trivette		Moved.
	Harbo		2nd.

Tape No.	Speaker	Subject
	Schubert	Technical corrections I'll give to staff, if no objection. Motion passed without objection.
7		**Pension Obligation Bond Panel** Michael O'Leary, Chester Johnson, Cynthia Weed, Jeffrey Sinz (intros by Tom Boutin)
	O'Leary	Start with 1st presentation...(overhead slides)
[Bill Corbus arrived at 9:10 a.m.]		
		"You pays me now or you pays me late" - true for pension obligation bonds.
12		Pg 2 - topics that Tom asked me to focus attention.
		Pg 3 - Have to address earnings lost because of underfunding, not just underfunding. Actuary assuming assets are there to earn income every year. If sponsor issues bonds, immediately system is less underfunded, generating earnings. Somebody has to pay cost of bond service. No guarantee system will earn expectations. If it doesn't, then sponsoring entities will have to pay debt costs, plus continuing to pay normal cost of pension system, plus future potential unfunded liability.
14		Pg 4 - use of leverage...double edged sword.
		If you look at young pension plan, young work force, liabilities way out there, that fund has very long term investment horizon. Could have a very aggressive investment policy. But workforce in their 40s, shorter horizon for open plan. Corpus is large...little less aggressive policy is considered reasonable. But for closed plans, that's not true. No new benefits being earned, should be comparatively conservative policy.
20		July 1, 2006 - no new participants go into PERS system. Have to be a huge infusion of contributions going in. Dollar cost averaging. Somewhere down the road it will be appropriate to shift to more conservative policy. If in bonds exclusively, what would be appropriate discount rate? 4%, 5%? What would be effect on liabilities if discount rate was 4-5%? Liabilities would rise. Every % rise in the discount rate would be a 10-12% rise in liability rate. Actuaries always offer caveat based on discount rate...
25	Pihl	Aggravated by cashflow going out?
	O'Leary	It's ok to have 0 balance at end of life of plan. Just showing you the implications of bond obligations, sponsors are making payments.
		Pg 5 - from initial meeting. Where PERS and TRS are along efficient frontier. Most plans are somewhere near where you are.
28		Leverage from an employer perspective - pg. 6. Issuance of pension obligation bonds - levers their contributors' risk. Fact of life, like mortgages. The debt service on pension obligation bond is fixed, therefore less flexibility on that portion of the pension cost. More variable - in addn to that fixed payment, you continue to make normal cost distributions, plus unfunded liability. If fund earns more than borrowing costs... If fund earns less than borrowing costs, New Jersey example of bad experience. Really don't know

Tape No.	Speaker	Subject
		the answer until bonds are paid off.
34		Pg 7 How does it impact asset allocation from strategic perspective - shouldn t have significant effect. Probably shouldn't be altered. However, your risk tolerance may be different... May wish to rein in the volatility a bit. Others may feel you can afford a little more volatility to make more money, reduce pension cost. If someone invested in 2002, when market was in free fall...short term result would be poor, look like it was exacerbating problem, even though it would help in long term. Private equity investments are periodic with good GPs, where to invest in interim. Have a transition target maybe.
38		Pg 8 - PERS and TRS case, investment proceeds would be considerable. Pg. 9 - 2nd bullet point. cash flow pattern would change, planning liquidity needs more an issue. Pg 10 - What if scenario for Alaska. If issued POBs 3 years ago, you would have been better off. If done 5 years ago, would have been a loser (so far).
41		In terms of target, should an obligation get to 100% funded or some lower level? Some say 90% would be better... political dynamic
Tape 1, Side B (9:45 a.m.)		
0	Chester Johnson	(State Financial Officer) (no handout or overhead material) Tell a story..."it's simply a miracle." To emphasize the point that to borrow money is never a miracle. Can't make something out of nothing. POB can be used in certain circumstances, but to borrow to lessen the size of an unfunded liability can work (and did work in 90s) but can it work way out in the future. What rating agencies and honest brokers say about POBs...sometimes there are no other choices. New Jersey, Ilinois examples... Concerns that rating agencies have about use of POBs...debt paid out of GenFunds, immediately affects debt rating of fund. Market risk - will market return disappoint and make problem worse? Conversion of a soft liability into a hard one. Govt can't miss a debt service payment, but can miss a pension payment. Increased pension liability, addl debt can push aside other capital projects. Is 100% funded position a good idea? Many analysts have reservations about 100% funded, creates incentive for govt to give addl benefits. Even research staff of investment bankers have written about credit problems with POBs. UBS...sees it as credit negative, reduces long term operating capability.
		several minutes of blank tape before start
10		Is AK in trouble credit wise because of size of unfunded liabilities? Fitch says that declines were consistent with general equity market trends. S&P says state is allocating $$ to cover burden of employers. Moody's says...some concern, state has addressed by DCP for future employees. Lessened by retiree medical benefits included. What does it suggest? AK has AA rating, strong credit position. Unfunded pension liability of AK is in the pack, doesn't stand out from others, even tho AK offers health benefits. AK not in position to use POBs... But if decision to use POB as state or local levels, structural issues. Bonds

Tape No.	Speaker	Subject
		are taxable. Foreign purchasers have been active in POB market. ...callability of bonds after a certain # of years...
15		Circumstances that POBs would be issued in future: revenues are still recovering from economic slow down. Facing rising interest rate environment = lower investment return. Don't know how economics will stand up over life of bond issuance. Question whether market risk is worth it.
18	Schubert	Is there committee hearing?
	Audience	My colleague still not here yet, he's at hearing.
19	Schubert	Break now for 15 mins.
Break at 10:02 a.m. to 10:22 a.m.		
20	Cynthia Weed	State Bond Counsel (with Preston Gates Ellis LLP) Legal Issues Starting with presumption that you've decided to do POBs, and if we could, how would we do this. Definition of debt... State constitutional issues: need voter approval.
23		Local general obligation bonds for pension obligations: also requires voter approval. Revenue debt: public organizations as alternative. Debt that is not really debt - structuring ideas. Certificates of participation. Lease and lease back obligations. Not debt for constitutional purposes. State retains right to walk away from facility and not make payments..holders of COP would not be happy but no recourse.
27		Anchorage example: has powerful rep in WA, DC. Tax exempt debt and taxable borrowing in early 1990s. One mechanism that might be available to do pension financing. HB 278 - Give Bond Bank authority to issue bonds... source of repayment of bonds? For employers? How I see it - if bond bank issues bond on behalf of local government...subject to constitutional limitations.
[Backup 2A]		Might be able to use lease and leaseback structure... How that works...consolidate debt to get access to the market. Moral obligation of the state to fund a reserve if there was a shortfall in the Bond Bank. This idea would change... Intercept concept -
	Semmens	Only if you're receiving $$...
	Weed	Yes.
Tape 2, Side A (10:40 a.m.)		
0	Weed	Other Options - Constitutional Amendment...rainy day fund. Dollar switching...from other projects. Conclusion: no perfect solution. Read GFOA.org - active committee working on pension funding, resources on website, qns you should ask before get[illegible] into a program.
4	Jeffrey Sinz	Chief Fiscal Officer, Muncipality of Anchorage (overhead presentation) Important issues to employers in state, as well as taxpayers of local

Tape No.	Speaker	Subject
		governments.
		Speak strongly from alternative position. POBs are good tool, premature to dismiss them because of limited options. Array of perspectives on this issue, mine is local employer perspective. No opportunity for local govts to act independently, but is potential to work through POBs. PERS is statewide system, should be addressed in statewide way. ANC doesn't want to have to act alone.
9		Fond of word "substitute". Introduction page - reads points...
12		Challenge/Opportunity... one response was SB 141, creation of Tier IV. Another is increasing contribution rates.
		PERS Challenge/Opportunity...
15		Anchorage Challenge... $462 million shortfall in PERS. Translates for ANC taxpaper when implemented is 2 mills or $500 a year addl property taxes. Significant.
		Anchorage Opportunity...slightly more conservative view of the world.
19		Current Risks. Financial - earnings, market trends (timing), ratings, risk. Administrative risk - accounting, investment management (undefined policy question), cost allocations, plan flexibility (what to do with excess proceeds). Legal - isn't clear to us at this point. Need clarity. Political - ANC doesn't want to be ahead of the curve.
26		Summary: financial impacts are real, substitution of lower pension debt can reduce cost, access to pension debt markets are unclear..., and HB 278 is step in right direction but not ready to go in its current state.
		MOA hasn't reached decision on POB yet, but believe that research done to date should be fully explored.
29	Schubert	Thank presenters. Questions now.
	Williams	MOA's ability to issue GOBs, is local voter approval required?
	Sinz	Don't know. Appropriation debt of some form,
	Weed	What they have done so far hasn't been subject to voter approval. Haven't seen all the ideas yet.
	Sinz	Mayor would make call.
31	Williams	Johnson - negative about booking a liability. Govt acctg standards coming to disclose unfunded liabilities, so raters will count that for AK.
	Johnson	Debt and assets ratio to compute...compared on a national basis. Debt Computation does not include liability for pension funding.
36		Neither Fitch or S&P commented on AK's situation. Health care counted in state's obligation, concerned about that. May cause other state's to include HC in their computation. AK less concern about unfunded liability at this point.
38	Semmens	If nothing is done, municipality could have contribution of close to 30%, affect rating ability to repay debt?
	Johnson	As % rises over time, underlying credit characteristics deteriorate.
40	Semmens	Why would MOA do this? Hardship on municipality?

Tape No.	Speaker	Subject
	Sinz	Local impact on tax rate. MOA has tax limitation in its charter
Tape 2, Side B (11:23 am) Backup 2B, 4 mins.		
0	Sinz	Tax increase takes up space that could be used for other projects... Will keep on reviewing until we reach conclusion about POBs.
1	Trivette	At cap now? Will have to reduce $$ elsewhere? Yes.
	Sinz	60% of operating budget is labor.
	Trivette	May have to get rid of employees?
	Sinz	Yes.
	Nordstrand	Financial impact on household, what is reduction of different calculation?
	Sinz	20% of $500 would be shaved off.
	Nordstrand	26% instead of 28.6%.
4	Pihl	What contribution rates have gone from, dramatic.
	Sinz	Magnitude of the problem from afar doesn't look that bad. But looked at from local level, these numbers are defensible.
6	Pihl	We had contribution rates that were way under what they should have been to support the pension plans we have, that's part of the problem.
	Sinz	Radically different than it is today.
	Millhorn	Callability of different bonds - sounds like we'd want that. What is cost?
	Johnson	In tax exempt market, ability to call bonds after 10 yrs at no premium. Perception is you should do that to maintain flexibility. In taxable market tends to be bigger penalties for calling bonds.
11	O'Leary	What is premium on untaxed bonds?
	BMitchell	Varies, not trivial.
	JMitchell	Don't look at either you do or don't do, but it could be a quiver, go from 70 to 80% or 85%, use as an experiment to see how it works.
13	Harbo	Doesn't address rising health care costs. POBs analogous to paying off CC debt by home equity loan. How do you allocate $$ that comes in all at once?
	O'Leary	Most common answer is to invest it immediately per policy, but difficult to do. Think it through before you get the $$. check risk preferences. Approaches vary...
16	Bader	Curious about how much is available once all expenses are paid?
	johnson	Size of bonds matters. Maximum 2% down to 1% for larger amount.
	Trivette	No of years?
	Johnson	25-30 years. Usually matches...
18	Schubert	Do POBs have any advantage over increasing equities over fixed income, less risk?
	O'Leary	Don't know right off. Thought process, which has more risk... Some plans get more risky trying to make up earnings for unfunded liability. Interesting question.
20	Schubert	Concluded presentations. Thank you.
	Schubert	Chair Report. I met with 2 commissioners, discussed committee memberships. Do next

Tape No.	Speaker	Subject
		mtg. I testified at Ways and Means Committee by teleconference, as well as others. Also Report to Leg Committee, we'll do that later. Letter from Sen. Kim Elton in packet - to calculate costs for Tier III and VI employees. Leave that to staff to respond to Senator.
23	Schubert	Recess for lunch now.
End of Tape 2, Side B		

Katie - get this to see
+ asks to be copied
with staff response

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM January 5, 2006

SUBJECT: Municipal bonds for pension plans (Work Order 24-LS1458)

TO: Representative Bruce B. Weyhrauch

FROM: Tamara Brandt Cook
Director TBC

You ask whether state law prevents municipalities from issuing pension bonds. I understand that these bonds are to be paid for from the general revenue of the municipality. If the bonds create a general debt of a municipality, like a general bond issue, they are subject to the limitation on acquisition of debt by municipalities under Art. IX, sec. 9 of the state constitution. (See Village of Chefornak v. Hooper Bay Constr. Co., 758 P.2d 1266 (Alaska 1988))

Art. IX, sec. 9 states in full: "No debt shall be contracted by any political subdivision of the State, unless authorized for capital improvements by its governing body and ratified by a majority vote of those qualified to vote and voting on the question." Note that this type of debt may not be used to finance pension plans because its use is limited to capital improvements. (City of Juneau v. Hixson, 373 P.2d 743 (Alaska 1962))

Art. IX, sec. 10 permits borrowing to meet appropriations for a fiscal year, but this type of interim borrowing must be paid before the end of the next fiscal year. It could only be used to fund a pension plan on a short term basis. Other exceptions to the restraint on borrowing are found in Art. IX, sec. 11, but it is not obvious to me how these exceptions might be used to fund pension plans. That section provides:

> SECTION 11. Exceptions. The restrictions on contracting debt do not apply to debt incurred through the issuance of revenue bonds by a public enterprise or public corporation of the State or a political subdivision, when the only security is the revenues of the enterprise or corporation. The restrictions do not apply to indebtedness to be paid from special assessments on the benefited property, nor do they apply to refunding indebtedness of the State or its political subdivisions.

For examples of creative state funding methods that have been upheld by the court see Myers v. Alaska Housing Finance Corp., 68 P.3d 386 (Alaska 2003) involving the sale of the right to future payments from the tobacco settlement to secure revenue bonds, and Carr-Gottstein Properties v. State, 899 P.2d 136 (Alaska 1995) involving the issuance and sale of certificates of participation in a lease-financing arrangement.

TBC:ljw
(06-005.ljw

Post-it® Fax Note 7671	Date 1/20/06	# of pages ▶ 1
To Will Comm.	From [illegible]	
Co./Dept.	Co.	

Tom Boutain — Dept Director
opposes for State - State credit

HB278 ?

If lease structure
extend moral obligation
1.3 bill now
500 - AK Student Loan
Bond Bang
Energy Authority
limit less than 6 bil but not treated
larger Community would use up
the

Size of community

Deven
Appropriation backed pledge

Jeff Sinz –

P.O.B. preservation of options

3 hurdles

Access & marketplace Are OK
others do not

Access to financial expertise

Uncertainty on ways of using
1) what does system do
invest in pool
? highly successful immediately see benefits
? " unsuccessful.

* other resources PERS + TRS ? pay from State

2005 ANNUAL REPORT

THE BOND BANK *An Idea That Works*

THE BOND BANK *An Idea That Works*

LETTER FROM THE GOVERNOR

The Office of
Governor Frank H. Murkowski

December 2005

Dear Alaskans:

It seems that too often, whether through over-regulation or bureaucratic inefficiency, government hinders rather than helps construction of sound economic development or public works projects.

I am proud to present the Alaska Municipal Bond Bank Authority as a great example of government getting it right. The job of the authority is to help municipalities. This report shows that in fiscal year 2005 the authority issued $123.0 million in bonds and provided direct savings of $16.7 million to Alaska municipalities.

Local governments sell their bonds to the authority to achieve lower costs and take advantage of the Bond Bank's high credit ratings. Because bonds issued by the authority are backed by the moral obligation of the state, they have higher credit ratings than bonds issued by most Alaska municipalities.

In fiscal year 2005, bonds sold by the authority financed school construction in Kodiak, Petersburg, Sitka, and Ketchikan; harbor improvements in Adak; a hospital in Juneau; street improvements in North Pole; and a new ice rink in Palmer. It also financed roof repairs for Anchorage's Performing Arts Center and refinanced outstanding bonds for savings to Haines, Palmer, Ketchikan, Fairbanks, Cordova, Sitka, Unalaska, and the Northwest Arctic Borough.

My administration has made a concerted effort to maintain the state's credit ratings over the past three years. The payoff for fiscal discipline, curtailing the use of debt, and laying the groundwork for a long-term fiscal plan has been a return to stable credit ratings. In the case of the Bond Bank, this has resulted in a credit upgrade to A1 from Moody's Investors Service in fiscal year 2005. It is gratifying to see these efforts converted to real and measurable savings for Alaskans throughout their municipal governments.

Our job is not finished. Economic and resource development through improved infrastructure and efficient government continue as a main focus of my administration.

The benefits of the effort come in greater opportunities for Alaskans to find the careers needed to raise families and enjoy the great bounty of the Last Frontier.

Sincerely yours,

Frank H. Murkowski
Governor

ALASKA MUNICIPAL BOND BANK AUTHORITY

2005 ANNUAL REPORT

PO BOX 110405
JUNEAU, ALASKA 99811-0405

LETTER FROM THE CHAIRPERSON

To all Alaskans:

The year 2005 marked the 30th year of existence for the Alaska Municipal Bond Bank Authority (Bond Bank). Since its inception in August of 1975, the Bond Bank has helped Alaskan communities secure over $800 million dollars in financing for public works projects that have improved the standards of health, safety and education for our citizens. The municipalities using the services of the Bond Bank have realized significant savings, reducing the burden on taxpayers throughout the state.

The Bond Bank was created to assist Alaskan communities issue bonds. Some communities simply lack familiarity with the financial markets, others seek to reduce the cost of issuing bonds, and some municipalities find they can get better terms on bonds issued by the Bond Bank.

The Bond Bank realizes savings for communities in a number of ways. We pool bonds, selling much larger issues than any one community would, thereby creating economies of scale. Because of our level of activity, we contract for professional services at a lower cost than could less active bond issuers. The Bond Bank also has a better credit rating than is available to most communities, resulting in lower interest rates.

The Bond Bank provides services to urban and rural communities in every region of the State as demonstrated by a review of the financial information that follows.

Beginning in 1977, the Bond Bank has remitted to the State of Alaska annual investment earnings in excess of operating needs. At $26.9 million, those remittances now exceed, by over $8.3 million, the $18.6 million appropriated by the State of Alaska to the Bond Bank between the years 1976 and 1986.

Fiscal year 2005 saw a continuation of the trend of increased use of the Bond Bank. Six series of bonds were issued for $123 million for fourteen Alaskan communities. Bond Bank participation in these transactions is estimated to have saved over $16.7 million.

The Bond Bank is indeed an idea that works an example of the benefits that can be realized through good government.

In accordance with Alaska Statute 44.85.100, we respectfully submit the attached year 2005 report of the activities and financial condition of the Bond Bank.

We hope you share with us our pride in the Bond Bank's accomplishments this outstanding year.

Sincerely,

R. Desmond Mayo

R. Desmond Mayo

THE ALASKA MUNICIPAL BOND BANK AUTHORITY

The Bond Bank is a public corporation that aids Alaskan communities by issuing bonds, and using the proceeds to purchase the municipalities' general obligation and revenue bonds. It commenced operations in August 1975.

The Bond Bank has a legal existence independent of and separate from the State of Alaska. Bonds issued by the Bond Bank are payable only from Bond Bank funds. The State has pledged its moral obligation to the maintenance of a debt service reserve for all of the Bond Bank's bonds. (For more information please see Notes to Financial Statements.)

The powers of the Bond Bank are vested in its Board of Directors. The membership of the Board consists of five directors representing both the public and private sector. The three private sector board members are appointed by the Governor and serve four-year terms. They are joined on the Board by the Commissioner of Revenue and the Commissioner of Commerce, Community & Economic Development (or their assigned representatives).

The Board of Directors operates in accordance with the Bond Bank Act (AS 44.85), its published regulations (15 AAC144) and its by-laws. The board's main responsibility is to approve bond issues.

The Bond Bank may not issue revenue bonds in excess of $75 million in any fiscal year unless the Alaska Legislature approves a greater amount. The Bond Bank is further restricted to a limit of $500 million of bonds or notes outstanding. As of June 30, 2005, obligations totaled $409.4 million, allowing for additional bond issuances of approximately $90.6 million.

ALASKA MUNICIPAL BOND BANK AUTHORITY

AN IDEA THAT WORKS

The Bond Bank pays its own way. The Bond Bank's reserve accounts serve to both guarantee the bonds and provide investment income. All of the Bond Bank's costs are paid from these investment earnings. The statutory earnings from its investment accounts exceeded expenses by $402,427 during the fiscal year ending June 30, 2005. Such excess funds are payable to the State of Alaska. The Bond Bank is transferring $250,000 of non statutory investment earnings to the State of Alaska in fiscal year 2006. Since 1977 the Bond Bank has returned excess earnings to the State for a cumulative total of $26.9 million, exceeding by over $8.3 million the State's original investment of $18.6 million (appropriated in the years 1976 through 1986).

Alaska's investment in the Bond Bank is compounded in other ways.

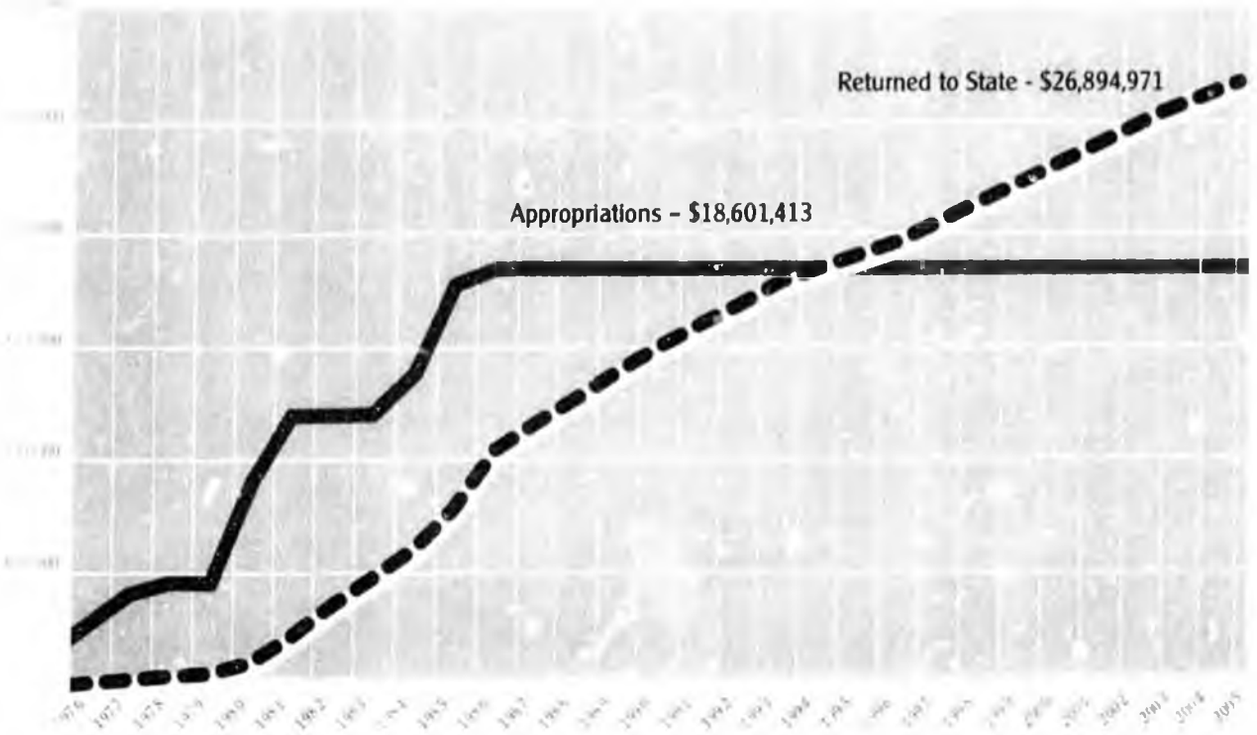
Alaskan communities taking advantage of the Bond Bank's services realize considerable savings. These communities may have low bond ratings or, although credit worthy, have not issued bonds or notes, or have little outstanding debt, and lack investor familiarity.

Some larger communities, capable of issuing their own bonds, find that the Bond Bank's services result in less expense, especially for small bond issues.

In addition to the annual dividends received from the Bond Bank, it costs the State of Alaska less money to reimburse communities for such capital projects as schools built with funds provided by Bond Bank issues. Since bonding expenses for Alaskan communities are less than they would be otherwise, the interest expense is less for the State.

The Bond Bank operates efficiently. Department of Revenue staff serve as executive director and provide accounting support. Where economies of scale dictate, the Bond Bank hires outside professional staff.

CUMULATIVE APPROPRIATIONS COMPARED TO CUMULATIVE EXCESS EARNINGS RETURNED TO STATE

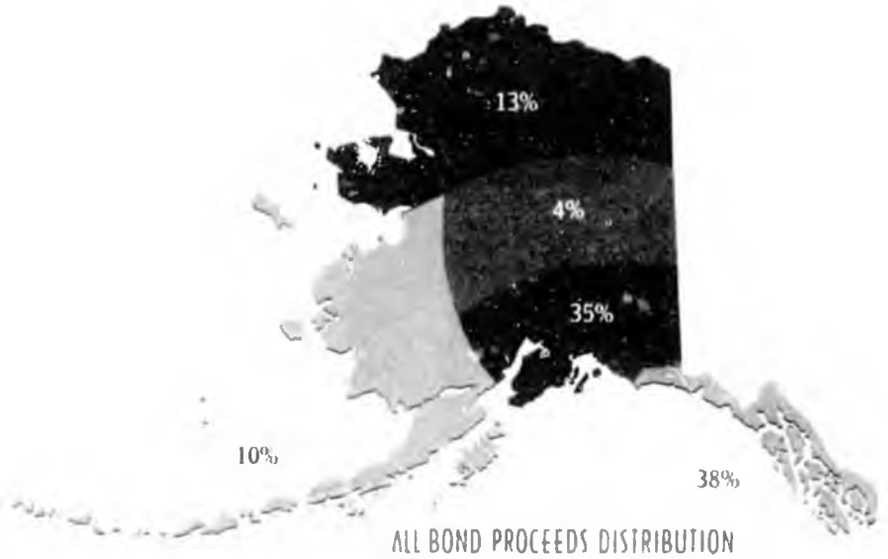


HELPING ALASKAN COMMUNITIES

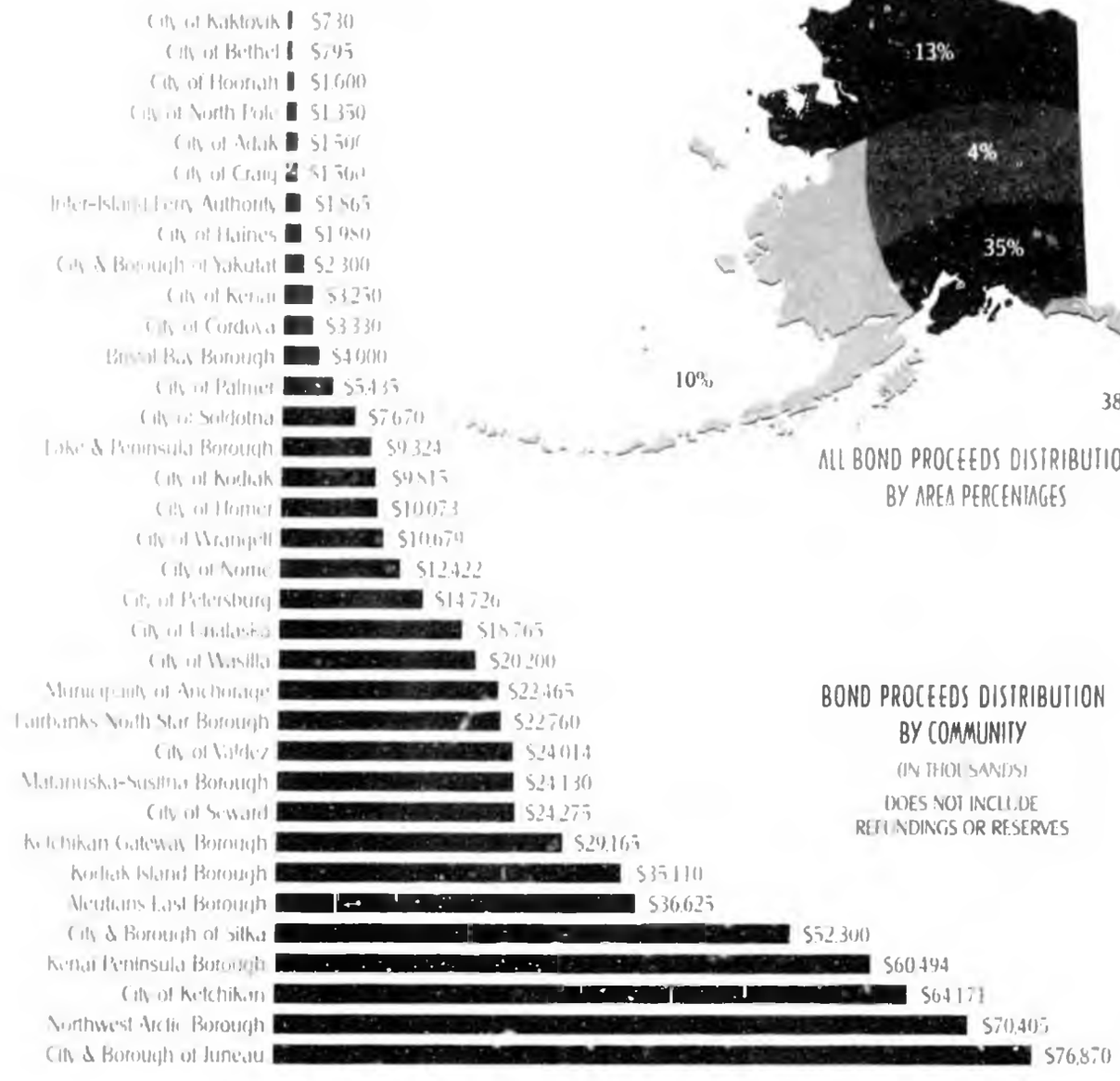
The Bond Bank is organized to work with all Alaska municipalities, especially new and infrequent issuers of debt for capital projects. From the time a municipality contacts the Bond Bank, legal and financial professionals with extensive experience in Alaska financing begin working with municipal managers to develop the most advantageous financing program for the community.

If it becomes clear that debt financing through the Bond Bank is neither possible nor appropriate, for any particular municipality, the Bond Bank will continue to work with the municipality's administration to find other means or ways of meeting their financial objectives.

In most instances the Bond Bank is able to relieve municipalities from paying certain costs of issuing bonds, such as official statement printing, trustee and paying agent fees. For this reason, even large communities with a track record of issuing bonds occasionally seek the services provided by the Bond Bank.



ALL BOND PROCEEDS DISTRIBUTION
BY AREA PERCENTAGES



BOND PROCEEDS DISTRIBUTION
BY COMMUNITY
(IN THOUSANDS)
DOES NOT INCLUDE
REFUNDINGS OR RESERVES

ISSUING BONDS

The Bond Bank issues mostly tax exempt bonds. Purchasers of these bonds, including bond mutual funds, institutional investors, and insurance companies do not have to pay taxes on the income received.

Each individual issue of the Bond Bank is reviewed by Moody's Investors Service and Standard and Poor's Corporation. Because the Bond Bank has received 'A' ratings, considered "investment grade," from two major national bond rating agencies, it is able to borrow money at lower interest rates than most Alaskan municipalities.

In addition, when it is economical and cost effective to do so, the Bond Bank obtains bond insurance, and thereby secures 'AAA' ratings.

The Bond Bank strengthens its portfolio by including Alaskan communities widely distributed geographically, with different economic bases, and limiting the total percentage of bonds committed to any one municipality.

The Bond Bank often pools municipal general obligation bond issues into a single issue. Following the sale of the issue, the Bond Bank purchases the individual issues from each community.

LEVERAGING STATE DOLLARS

An important reason for the Bond Bank's favorable bond rating and lower borrowing costs is that it secures its bonds with reserve funds supported by the "moral obligation" of the State of Alaska.

The reserve funds are available to cure defaults, should they occur. For General Obligation Bonds, two-thirds of the reserve is funded from bond bank assets and one-third is funded from the proceeds of new bond issues.

The reserve fund is normally used to leverage debt at better than an eleven to one ratio. For every $1 million placed in the reserve fund, more than $11 million of outside capital is attracted to the state.

CURRENT FINANCINGS FY 2005 BONDS ISSUED

$14,575,000

GENERAL OBLIGATION BONDS 2004 SERIES C
City of Palmer – Ice Rink
City of Petersburg – Elementary, Middle and High School Renovations
Standard & Poor's AAA; Moody's Aaa: FSA Insurance
Competitive Sale – CityGroup Global Markets
20 year: True Interest Cost 4.373%

$28,845,000

REVENUE BONDS 2004 SERIES A
City & Borough of Juneau – Hospital
Standard & Poor's AAA: Fitch AAA: MBIA Issued
Negotiated sale – RBC Dain Rauscher
30 year: True Interest Cost 4.962%

$5,365,000

REVENUE BONDS 2004 SERIES B
Municipality of Anchorage – Performing Arts Center
Standard & Poor AAA: Fitch AAA: MBIA Insured
Competitive Sale – Wachovia Securities
30 year: True Interest Cost 4.732%

$13,925,000

GENERAL OBLIGATION BONDS 2004 SERIES D
Kodiak Island Borough – High School and New Pool
City of Adak – Small Boat Harbor
Standard & Poor's AAA: Moody's Aaa: XL Capital Insured
Competitive Sale – Wells Fargo Brokerage
20 year: True Interest Cost 4.176%

$32,655,000

GENERAL OBLIGATION BONDS 2005 SERIES A
City of Ketchikan, City of Fairbanks, City of Cordova, City of Unalaska, City and Borough of Sitka, Northwest Arctic Borough – Refunding
Standard & Poor's AAA: Moody's Aaa: FGIC Insured
18 years: True Interest Cost 4.2035%

$27,625,000

GENERAL OBLIGATION BONDS 2005 SERIES B
City of North Pole – Street Improvements
City and Borough of Sitka – Elementary, Middle & High School Improvements
Ketchikan Gateway Borough – Elementary and Middle School
Haines Borough and City of Palmer – Refunding
Standard and Poor's AAA: Moody's Aaa: MBIA
20 years: True Interest Costs 3.9385%

Issued amounts are inclusive of Reserve obligations

GENERAL OBLIGATION BONDS

Municipal general obligation bonds, the Bond Bank's mainstream program, are usually issued to finance facilities that do not generate revenue, such as schools, roads, public safety and municipal buildings. Such bonds must be approved by the municipal voters.

Bonds issued by the Bond Bank to purchase municipal general obligation bonds are secured by:

- Full faith and credit of each respective community with no taxing limitation for the general bonded debt issued to the Bond Bank.
- The Bond Bank's general obligation debt service reserve fund. This reserve is generally funded in an amount equal to maximum annual debt service on all the Bond Bank general obligation bonds.
- All Bond Bank assets shall be used to restore the debt service reserve to an amount that equals the maximum annual debt service on the Bond Bank bonds.
- The statutory right of the Bond Bank, in the event of default, to demand and receive any funds held by a state agency which are payable to the defaulting municipality.
- The moral obligation of the State of Alaska to maintain the debt service reserves at their required levels.

REVENUE BONDS

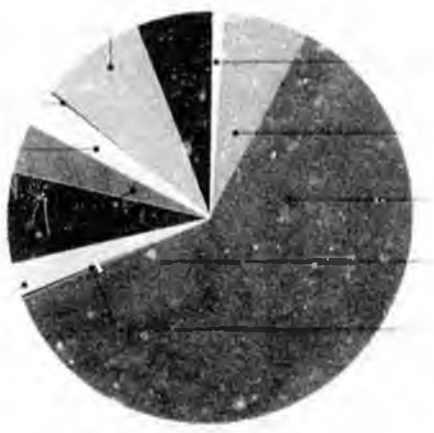
Revenue Bonds are used to finance revenue-producing capital improvements such as utility or port facilities. Because they are not secured by a municipality's taxing power, such bonds do not normally require municipal voter approval.

Bonds issued by the Bond Bank to purchase municipal revenue bonds are secured by:

- A pledge of the revenues from the facility being financed.
- The municipalities' reserve fund under their bond resolutions. The reserve fund generally is funded in an amount equal to maximum annual debt service on the municipalities' bonds.
- The Bond Bank reserve fund under the bond resolution for that issue. The reserve fund generally is funded in an amount equal to maximum annual debt service on the Bond Bank bonds.
- The statutory right of the Bond Bank, in the event of a default, to demand and receive from a state agency any funds held by that state agency which are payable to the defaulting municipality.
- The moral obligation of the State of Alaska to maintain the debt service reserves at their required levels.

USES OF BOND PROCEEDS — INCEPTION TO DATE

DOES NOT INCLUDE REFUNDINGS



SUMMARY OF DEBT SERVICE

SCHEDULE OF TOTAL DEBT SERVICE BY CLASSIFICATION AT JUNE 30, 2005

1976 GENERAL BOND RESOLUTION FUND	PRINCIPAL	INTEREST	TOTAL
1995 Series A	$ 2,330,000	134,750	2,464,750
1995 Series C	1,090,000	32,700	1,122,700
1995 Series D	90,000	2,644	92,644
1996 Series A	610,000	27,450	637,450
1996 Series B	895,000	61,931	956,931
1997 Series A	385,000	29,390	414,390
1997 Series B	1,435,000	103,320	1,538,320
1998 Series A	6,500,000	2,289,201	8,789,201
1998 Series B	1,830,000	225,268	2,055,268
1999 Series A	10,045,000	3,803,634	13,848,634
2000 Series A	2,830,000	406,175	3,236,175
2000 Series B	2,960,000	623,775	3,583,775
2000 Series C	6,360,000	1,233,868	7,593,868
2000 Series D	1,580,000	851,326	2,431,326
2000 Series E	11,050,000	2,756,937	13,806,937
2000 Series F	810,000	213,060	1,023,060
2001 Series A	14,270,000	6,657,000	20,927,000
2001 Series B	3,480,000	1,583,934	5,063,934
2002 Series A	12,470,000	2,433,975	14,903,975
2002 Series B	11,055,000	5,053,623	16,108,623
2003 Series A	8,745,000	4,020,297	12,765,297
2003 Series B	2,035,000	79,200	2,114,200
2003 Series C	6,800,000	1,051,538	7,851,538
2003 Series D	13,965,000	6,913,223	20,878,223
2003 Series E	31,125,000	24,888,937	56,013,937
2003 Series F	1,690,000	122,087	1,812,087
2003 Series G	22,825,000	12,069,287	34,894,287
2004 Series A	19,190,000	5,926,097	25,116,097
2004 Series B	16,690,000	6,234,875	22,924,875
2004 Series C	14,575,000	7,140,192	21,715,192
2004 Series D	13,925,000	6,649,633	20,574,633
2005 Series A	32,655,000	16,177,276	48,832,276
2005 Series B	27,625,000	12,633,697	40,258,697
	303,920,000	132,430,300	436,350,300

COASTAL ENERGY IMPACT PROGRAM REVENUE BONDS	PRINCIPAL	INTEREST	TOTAL
Coastal Energy Reserve Loan Fund	11,005,878	-	11,005,878
1995A Revenue Bond Resolution	2,265,000	759,293	3,024,293
1997A Revenue Bond Resolution	13,935,000	5,756,352	19,691,352
1998A Revenue Bond Resolution	6,170,000	1,196,700	7,366,700
1998B Revenue Bond Resolution	1,105,000	113,222	1,218,222
1999A Revenue Bond Resolution	1,660,000	809,324	2,469,324
2000A Revenue Bond Resolution	445,000	24,030	469,030
2000B Revenue Bond Resolution	2,725,000	1,386,249	4,111,249
2001A Revenue Bond Resolution	1,550,000	566,344	2,116,344
2001B Revenue Bond Resolution	2,285,000	885,611	3,170,611
2002A Revenue Bond Resolution	5,380,000	1,193,975	6,573,975
2003A Revenue Bond Resolution	2,935,000	92,337	3,027,337
2003B Revenue Bond Resolution	19,000,000	9,982,156	28,982,156
2003C Revenue Bond Resolution	820,000	55,175	875,175
2004A Revenue Bond Resolution	28,845,000	27,554,705	56,399,705
2004B Revenue Bond Resolution	5,365,000	4,714,045	10,079,045
	$ 409,410,878	187,519,818	596,930,696

SUMMARY OF TOTAL DEBT SERVICE REQUIREMENTS BY FISCAL YEAR

FISCAL YEAR	PRINCIPAL	INTEREST	TOTAL
2006	31,885,000	17,960,479	49,845,479
2007	25,240,000	16,598,854	41,838,854
2008	22,530,000	15,696,521	38,226,521
2009	21,785,000	14,826,328	36,611,328
2010	21,905,000	13,947,354	35,852,354
2011-2015	106,440,000	55,656,371	162,096,371
2016-2020	93,730,878	33,431,444	127,162,322
2021-2025	59,645,000	13,399,601	73,044,601
2026 and after	26,250,000	6,002,866	32,252,866
	$ 409,410,878	187,519,818	596,930,696

THE BOND BANK HAS FIVE DIRECTORS CONSISTING OF THREE PUBLIC MEMBERS APPOINTED BY THE GOVERNOR. THE COMMISSIONER OF REVENUE AND THE COMMISSIONER OF COMMUNITY AND ECONOMIC DEVELOPMENT.

THE COMMISSIONERS HAVE TRADITIONALLY APPOINTED DELEGATES TO SERVE IN THEIR PLACE

THE BOARD OF DIRECTORS

R. DESMOND "DESI" MAYO

Chairman

Term expires July 15, 2007

Mr. Mayo was appointed on September 15, 1999 and reappointed on July 29, 2003. Mr. Mayo is the Chief Financial Officer of the Matanuska Telephone Association. Prior to his current employment, Mr. Mayo has served as Chief Financial Officer for the Matanuska-Susitna Borough and more recently Municipal Light and Power, an enterprise of the Municipality of Anchorage. He has also served in the capacity of Corporate Controller for Alyeska Pipeline Service Company. Mr. Mayo graduated from the University of Alaska and has attended graduate classes at Alaska Pacific University. Mr. Mayo served as Governor Knowles' appointee to the Alaska State Pension Investment Board and served on Governor Murkowski's Mat-Su Finance Policy Transition Team. Mr. Mayo has also served on the boards of Northwest Public Power Association, Matanuska Electric Association, Alaska Rural Electric Cooperative Association, the United Way of Matanuska-Susitna Borough and Habitat for Humanity Mat-Su.

MARK PFEFFER

Vice Chairman

Term expires July 15, 2009

Mr. Pfeffer was appointed October 10, 2001. Mr. Pfeffer is a registered architect who has owned and led an architectural practice in Alaska for over 20 years. He is active in the development, design and management of commercial real estate projects, many of which include public/private partnerships. He is a partner in the firms Koonce Pfeffer Bettis, Inc. and Venture Development Group, L.L.C. Mr. Pfeffer received a Bachelor of Architecture Degree from the University of Nebraska in 1980.

TOM BOUTIN
Member

Mr. Boutin is the first delegate for William A. Corbus, Commissioner of the Department of Revenue. Mr. Boutin spent his first 22 years in New Hampshire, logging and working for dairies. He then moved to Alaska, working as a logging engineer for Ketchikan Pulp Co. and as a timber faller, rigging slinger and equipment operator for various logging and road building firms. He bought and sold logs, lumber, veneer and plywood for North Pacific Lumber Company, and was chief Financial Officer and then President and Chief Financial Officer for Klukwan, Inc. an ANCSA corporation involved in forest products and money management. His government service experience consists of State Debt Manager for the Alaska Department of Revenue, Alaska State Forester, and currently, Deputy Commissioner for the Alaska Department of Revenue. Mr. Boutin has a Bachelor of Science from the University of New Hampshire, and an MBA in Finance from the University of Oregon. He has lived in Juneau for the past 20 years.

WILLIAM F. LARGE
Member
Term expires July 15, 2006

Mr. Large was appointed on May 2, 2005. Mr. Large is a member of the Alaska Bar and has practiced law in Alaska and nationwide for 10 years. His practice focuses primarily on complex commercial litigation, with emphases on national resources, oil & gas and corporate disputes. After graduating from law school in 1995, Mr. Large served as a law clerk for one year to the Hon. Andrew J. Kleinfeld, U.S Court of Appeals for the 9th Circuit, before joining the predecessor to his current firm, Hosie McArthur LLP. Mr. Large has a Bachelor of Science degree from the Massachusetts Institute of Technology and a Law Degree from Harvard Law School

GREG WINEGAR
Member

Mr. Winegar is the first delegate for William Noll, Commissioner of the Department of Community and Economic Development. Mr. Winegar was appointed Director of the Division of Investments on May 22, 2000. This Division administers various direct lending programs for the State and services loans for other State agencies, representing approximately 3,500 accounts totaling $250 million. Prior to his appointment as Acting Director, Mr. Winegar served as the Division of Investment's Lending Branch Manager for 21 years. Mr. Winegar received his Bachelor's degree from the Evergreen State College in 1973. In 1974, he accepted a position with the predecessor to the Department of Community and Economic Development as a Clerk Typist III and was promoted several times over the next five years. In addition to his work as Lending Branch Manager, he also served as a Loan Officer for the Department for five years where his responsibilities included credit analysis and recommendations for commercial, multi-family, residential and consumer loan requests.

THE STATE'S DEPARTMENT OF REVENUE–TREASURY DIVISION (DOR-TREASURY) FULFILLS ADMINISTRATIVE AND MANAGEMENT RESPONSIBILITIES FOR THE BOND BANK.

DEVEN MITCHELL

Executive Director, appointed April 7, 1998

Mr. Mitchell also serves as the State Debt Manager and Investment officer in Department of Revenue-Treasury. Mr. Mitchell has worked for the State of Alaska Department of Revenue since 1992. He previously held several positions in Alaskan financial institutions. Mr. Mitchell holds a Bachelor of Science in Business Administration from Northern Arizona University.

SUSAN TAYLOR, CPA

Deputy Treasurer, appointed August 9, 2005

Ms. Taylor is the State Comptroller for the Alaska Department of Revenue, Treasury Division. Ms. Taylor started her career as an auditor with the Legislative Audit Division; she has held various positions of increasing responsibility in Alaska state government. These included Senior Fiscal Analyst for the Legislative Finance Division, Budget Analyst for the Office of Management and Budget and positions with the Departments of Revenue and Health and Social Services. Ms. Taylor holds a Bachelor of Business Administrative-Accounting degree from the University of Alaska, Anchorage. She is a Certified Public Accountant in the State of Alaska, and a member of the American Institute of Certified Public Accountants.

RATHER THAN EMPLOY STAFF THE BOND BANK CONTRACTS IN THE PRIVATE SECTOR FOR A WIDE RANGE OF PROFESSIONAL SERVICES. THE EXECUTIVE DIRECTOR COORDINATES THE ACTIVITIES OF THESE PROFESSIONALS INCLUDING BOND COUNSEL, FINANCIAL ADVISOR, ACCOUNTANTS, AUDITORS, FUND TRUSTEES, BOND TRUSTEES AND CLERICAL SUPPORT.

FINANCIAL ADVISOR

WESTERN FINANCIAL GROUP, LLC

Provides loan analysis services, including recommendations as to the adequacy of loan applications, credit worthiness, projected capability to repay, and the overall effect a proposed loan will have on the credit of the Bond Bank. Assists in preparation of the official statements, recommends type and timing of bond sales, negotiates with underwriters and assists with investment of various funds. Also coordinates financial reviews with bond rating houses and prepares other general financial reviews and analyses required by the Bond Bank.

BOND COUNSEL

WOHLFORTH JOHNSON BRECHT CAPELEDGE & BROOKING

Prepares for the authorization, sale, issuance and delivery of Bond Bank bonds. Prepares series resolutions, notices of sale; assists in preparation of official statements; renders necessary opinions as required; and provides other general legal services.

TRUSTEE/PAYING AGENT

JP MORGAN TRUST COMPANY

Acts as custodian of the bond proceeds and supervises the investment of funds for the purposes specified in the bond resolutions. The trustee oversees debt service funds and maintenance of certain reserve accounts required in the contract with the bondholders. As paying agent, makes all necessary interest and principal payments to the bondholders.

INVESTMENT MANAGER

ALASKA PERMANENT CAPITAL MANAGEMENT COMPANY

Supervises and controls the investment of the custodial funds and the trustee funds. Also provides analyses of investments, advice on investment guidelines, and directs the investment of all funds in accordance with Authority procedures and guidelines.

CUSTODIAL BANK

FIRST NATIONAL BANK OF ALASKA

Acts as the Authority's bank for processing all fund transactions.

FINANCIAL STATEMENTS

JUNE 30, 2005

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MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis (MD&A) is required by GASB 34, a rule established by the Governmental Accounting Standards Board. This section is intended to make the financial statements more understandable to the average reader who is not familiar with traditional accounting terminology.

This financial report has two integral parts: this MD&A and the financial statements with the accompanying notes that follow. Together, they present the Alaska Municipal Bond Bank Authority's ("Bond Bank") financial performance during the fiscal year ended June 30, 2005. Summarized prior fiscal year information is shown within this MD&A, as needed for comparative purposes.

REQUIRED FINANCIAL STATEMENTS

GASB 34 requires two financial statements: the statement of net assets and governmental fund balance sheet and the statement of activities and governmental fund revenues, expenditures and changes in fund balances. These statements report financial information about the Bond Bank's activities using generally accepted accounting principles.

FINANCIAL HIGHLIGHTS

During fiscal year 2005 the Bond Bank approved 10 municipalities' applications and purchased $78.4 million in municipal bonds. The subsequent issuance of Bond Bank Bonds resulted in approximate savings of $14.8 million to the borrowing communities. Additionally, the Bond Bank entered into amended loan agreements on 10 existing bond issues and purchased $41 million in municipal bonds. The amended bond issues resulted in approximately $1.9 million in savings to the borrowing communities. Total bond issuance for FY2005 was $123.0 million, funding $119.4 million in 20 loans to 16 communities and providing total savings of $16.7 million. This activity level and community benefit is comparable to FY2004 when the Bond Bank issued $109.5 million to fund fourteen communities' projects and provided savings of $4.8 million to the borrowing communities.

The financial position of the Bond Bank remains strong. All reserves are fully funded and invested. Fiscal year 2005 investment earnings funded fiscal year 2005 operations and will provide for a $402,427 transfer to the state's general fund in fiscal year 2006. This transfer will be in addition to the $250,000 transfer provided in the state's fiscal year 2006 operating budget. The Bond Bank holds unrestricted reserves adequate to make up shortfalls in years that investment earnings are not sufficient to fund operations.

STATEMENT OF NET ASSETS

The statement of net assets report assets, liabilities and net assets of the Bond Bank.

ASSETS

Assets represent 1) the value of the Bond Bank's investments and investment income receivable on the financial statement dates, recorded at fair market value, and 2) bond principal and interest payments receivable from municipalities. The investments generate income for the Bond Bank to use to meet reserve requirements and pay operating costs. Excess investment earnings are distributed to the State of Alaska's (State) general fund each year. Interest received on bonds

purchased from municipalities is used to pay the Bond Bank's corresponding interest payments on the bonds that it has issued.

LIABILITIES

Liabilities represent claims against the fund for 1) goods and services provided before the financial statement date but not yet paid for at that date, and 2) interest and bond payments due to purchasers of the Bond Bank's bonds after the financial statement date.

RESTRICTED AND UNRESTRICTED NET ASSETS

Net assets are comprised of two components. The restricted portion reflects monies maintained in separate trust accounts where their use is limited by applicable bond covenants for repayment of bonds. The unrestricted portion reflects the accumulated excess of the Authority's share of earnings on investments held over those earnings distributed to the State as well as investment income that has not been realized and therefore is not yet subject to distribution to the State's general fund.

The following table shows the value of Bond Bank assets summarized as of June 30, 2005 and 2004 as well as liabilities and net assets.

	As of June 30		Change from 2004 to 2005 Increase (Decrease)	
	2005	2004	Dollars	Percent
ASSETS				
Cash and investments	$ 53,137,123	$ 50,396,591	$ 2,740,532	5.4%
Bonds and bond interest receivable	408,074,781	341,840,489	66,234,292	19.4%
Total assets	461,211,904	392,237,080	68,974,824	17.6%
LIABILITIES				
Accounts payable and accrued liabilities	3,658,817	178,126	3,480,691	1954.1%
Bonds and bond interest payable	418,074,486	352,446,648	65,627,838	18.6%
Due to primary government	402,427	-	402,427	100.0%
Total liabilities	422,135,730	352,624,774	69,510,956	19.7%
NET ASSETS				
Restricted	26,838,760	23,994,579	2,844,181	11.9%
Unrestricted	12,237,414	15,617,727	(3,380,313)	-21.6%
Total net assets	$ 39,076,174	$ 39,612,306	$ (536,132)	-1.4%

The increase in cash and investments reflects realized and unrealized investment income.

The increase in bonds and bond interest receivable, as well as in bonds and bond interest payable, reflects the issuance of approximately $123 million in new bonds during the year net of principal payments on bonds previously issued of over $54.7 million.

Communities monies received in advance of payment date are not applied to their debt liability until due. In FY2005 the increase was over $3.4 million for the change in accounts payable and accrued liabilities.

Due to primary government represents the excess of realized investment income over current year operating expenses and reserve requirements. The increase reflects higher investment earnings on fixed income marketable securities resulting in current year realized investment income greater than current year operating expenses. There is excess investment income in the current year due to primary government.

Restricted net assets represents the original appropriations made by the State of $18,601,414 to fund the Bond Bank, as well as Bond Bank funds placed into separate accounts in accordance with the reserve requirements of each bond indenture. There have been no new State appropriations since 1986. The increase in restricted net assets reflects a reclassification of one bond reserve fund as well as the funding of additional special reserves during the year from the Custodian account.

Unrestricted net assets represent accumulated earnings on Bond Bank investments, not used to fund reserves, and unrealized gains that are segregated until realized. The decrease in unrestricted net assets is due primarily to the funding of bond issue reserves. The Bond Bank's investments are all held in U.S. Government securities.

STATEMENTS OF ACTIVITIES

The statement of activities shows the activity that occurred during each of the last fiscal year.

Revenues

Revenues include earnings on investments and interest payments received from municipalities. Earnings on investments include interest on fixed income marketable securities and the change in fair market value of those investments.

Expenses

Expenses include interest payments made to bond holders who purchased the Bond Bank's bonds, payments made to the State of Alaska and operating expenses. Operating expenses include all expenditures required to issue bonds during the current year and include in-house expenses, as well as external consultant fees. Expenses are subtracted from revenues.

	For the Year Ended		Change from 2004 to 2005 Increase (Decrease)	
	June 30, 2005	June 30, 2004	Dollars	Percent
REVENUES				
Interest income on bonds receivable	$ 15,749,004	$ 11,32[illegible]112	$ 4,419,952	39.0%
Investment earnings	1,696,533	314,226	1,382,307	439.9%
Total income	17,445,597	11,64[illegible]338	5,802,259	49.8%
EXPENSES				
Interest expense on bonds payable	16,201,477	11,84[illegible]151	4,353,326	36.7%
Operating expenses	602,825	735[illegible]29	(132,704)	-20.2%
Payments to primary government	1,177,427	77[illegible]000	402,427	51.9%
Total expenses	17,981,729	13,37[illegible]680	4,603,049	33%
Change in net assets	(536,132)	(1,73[illegible]342)	1,199,210	-69.1%
Net assets, beginning of period	39,612,306	41,34[illegible]648	(1,735,342)	-4.2%
Net assets, end of period	$ 39,076,174	$ 39,61[illegible]306	$ (536,132)	-1.4%

Interest income and expense on bonds receivable and payable are a function of the total amount of bonds outstanding, the age of the bonds and the interest rates at which they are issued. The increases in both these line items are consistent with the net increase in bond interest receivable and payable of $8.5 million and $8.6 million, respectively.

Investment earnings are a function of market conditions. The Bond Bank uses other assets to subsidize debt service during times of low investment returns in bond reserve funds.

GOVERNMENTAL FUNDS

The governmental funds include the General Fund, which accounts for the primary operations of the Bond Bank, and the Debt Service Fund, which accounts for the resources accumulated and payments made on the long-term debt of the Bond Bank. The primary difference between the governmental funds and the statement of net assets is the elimination of inter-fund payables and receivables and bond proceeds are reported as an other financing source in the governmental funds and this contributes to the change in fund balance. In the statement of net assets, however, issuing debt increases long-term liabilities and does not affect the statement of activities. Similarly, repayment of debt principal is recorded as an expenditure in the governmental funds, but reduces the liability in the statement of net assets.

The following tables show the changes in governmental funds.

GENERAL FUND

	As of June 30,		Change from 2004 to 2005 Increase (Decrease)	
	2005	2004	Dollars	Percent
ASSETS				
Cash and investments	$ 10,687,308	$ 14,085,271	$ (3,397,963)	-24.1%
Accrued interest receivable	238,949	299,956	(61,007)	-20.3%
Inter-fund receivable	2,019,770	723,595	1,296,175	179.1%
Total assets	12,946,027	15,108,822	(2,162,795)	-14.3%
LIABILITIES				
Accounts payable and accrued liabilities	149,023	165,888	(16,865)	-10.2%
Due to primary government	402,427	-	402,427	100.0%
Total liabilities	551,450	165,888	385,562	232.4%
FUND BALANCE				
Unreserved	12,394,577	14,942,934	(2,548,357)	-17.1%
Total fund balance	12,394,577	14,942,934	(2,548,357)	-17.1%
Total liabilities and fund balance	$ 12,946,027	$ 15,108,822	$ (2,162,795)	-14.3%

DEBT SERVICE FUND

	As of June 30,		Change from 2004 to 2005 Increase (Decrease)	
	2005	2004	Dollars	Percent
ASSETS				
Cash and investments and related receivables	$ 43,638,791	$ 36,772,951	$ 6,865,840	18.7%
Bonds and bond interest receivable	406,646,856	341,078,902	65,567,954	19.2%
Total assets	450,285,647	377,851,853	72,433,794	19.2%
LIABILITIES				
Accounts payable and accrued liabilities	3,509,794	12,238	3,497,556	28579.5%
Interfund payables	2,019,770	723,595	1,296,175	179.1%
Total liabilities	5,529,564	735,833	4,793,731	651.5%
FUND BALANCE:				
Reserved	444,756,083	377,116,020	67,640,063	17.9%
Total liabilities and fund balance	$ 450,285,647	$ 377,851,853	$ 72,433,794	19.2%

GENERAL FUND

	As of June 30,		Change from 2004 to 2005 Increase (Decrease)	
	2005	2004	Dollars	Percent
REVENUES				
Interest income	$ 601,815	$ 256,257	$ 345,558	134.8%
Total income	601,815	256,257	345,558	134.8%
EXPENDITURES				
Operating expenses	602,825	755,529	(152,704)	-20.2%
Payments to primary government	1,177,427	775,000	402,427	51.9%
Total expenses	1,780,252	1,530,529	249,723	16.3%
Excess of revenues over expenditures	(1,178,437)	(1,274,272)	(95,835)	-7.5%
Other financing sources (uses) -Transfers	(1,369,920)	(1,551,805)	(181,885)	-11.7%
Fund balance beginning of period	14,942,934	17,769,011	(2,826,077)	-15.9%
Fund balance end of period	$ 12,394,577	$ 14,942,934	$ (2,548,357)	-17.1%

DEBT SERVICE FUND

	For the Year Ended		Change from 2004 to 2005 Increase (Decrease)	
	June 30, 2005	June 30, 2004	Dollars	Percent
REVENUES				
Interest income on bonds receivable	$ 15,664,431	$ 11,329,112	$ 4,335,319	38.3%
Investment earnings	1,179,351	57,969	1,121,382	1934.5%
Total income	16,843,782	11,387,081	5,456,701	47.9%
EXPENDITURES				
Interest payments	15,218,639	12,576,973	2,641,666	21.0%
Principal payments	58,345,000	34,975,000	23,370,000	66.8%
Total expenses	73,563,639	47,551,973	26,011,666	54.7%
Excess of revenues over expenditures	(56,719,857)	(36,164,892)	20,554,965	56.8%
Other financing sources -				
Bond proceeds	122,990,000	113,225,000	9,765,000	8.6%
Transfers	1,369,920	1,551,805	(181,885)	-11.7%
Excess of revenues and transfers over expenditures	67,640,063	78,611,913	(10,971,850)	-14.0%
Fund balance, beginning of period	377,116,020	298,504,107	78,611,913	26.3%
Fund balance, end of period	$ 444,756,083	$ 377,116,020	$ 67,640,063	17.9%

DEBT

At year end the Bond Bank had $398,123,878 of bonds and notes outstanding up 19% from $333,513,378 at June 30, 2004. The debt is secured by the assets of the Bond Bank. The outstanding balance is comprised of the following:

General obligation bonds payable	$ 294,157,500
Revenue bonds payable	92,960,000
Coastal Energy notes payable	11,005,878
	$ 398,123,378

INDEPENDENT AUDITORS' REPORT

ELGEE REHFELD MERTZ, LLC

The Board of Directors
Alaska Municipal Bond Bank Authority:

We have audited the accompanying basic financial statements of the Alaska Municipal Bond Bank Authority (the Authority), a component unit of the State of Alaska, as of and for the year ended June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of the management of the Authority. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Alaska Municipal Bond Bank Authority as of June 30, 2005, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 14 through 19, is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it. The Supplemental Schedule of Statutory Reserve Accounts – Assets, Liabilities and Account Reserves is presented for purposes of additional analysis and are not a required part of the basic financial statements. The schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as whole.

ERM

September 23, 2005

STATEMENT OF NET ASSETS AND GOVERNMENTAL FUNDS BALANCE SHEET

June 30, 2005

	General Fund	Debt Service Fund	Total	Adjustments (Note 6)	Statement of Net Assets
ASSETS					
Cash and cash equivalents	$ 212,461	5,324,110	5,536,571	-	5,536,571
Investments, at fair value (note 4)	9,614,847	37,985,705	47,600,552	-	47,600,552
Accrued interest receivable:					
Bonds receivable	15,469	8,523,478	8,538,947	-	8,538,947
Investment securities	223,480	328,976	552,456	-	552,456
Bonds receivable (note 5)	860,000	398,123,378	398,983,378	-	398,983,378
Interfund receivables	2,019,770	-	2,019,770	(2,019,770)	-
Total assets	$ 12,946,027	450,285,647	463,231,674	(2,019,770)	461,211,904
LIABILITIES					
Accounts payable	$ 12,277	-	12,277	-	12,277
Deferred revenue	-	3,509,794	3,509,794	-	3,509,794
Accrued interest payable	-	-	-	8,663,608	8,663,608
Arbitrage interest rebate payable	136,746	-	136,746	-	136,746
Due to Primary Government	402,427	-	402,427	-	402,427
Interfund payables	-	2,019,770	2,019,770	(2,019,770)	-
Long-term liabilities (notes 5 and 6)					
Portion due or payable within one year:					
General obligation bonds payable	-	-	-	21,695,000	21,695,000
Revenue bonds payable	-	-	-	4,790,000	4,790,000
Other long-term debt	-	-	-	5,400,000	5,400,000
Portion due or payable after one year:					
General obligation bonds payable	-	-	-	282,225,000	282,225,000
Revenue bonds payable	-	-	-	89,695,000	89,695,000
Other long-term debt	-	-	-	5,605,878	5,605,878
Total liabilities	551,450	5,529,564	6,081,014	416,054,716	422,135,730
FUND BALANCES/NET ASSETS					
Fund Balances:					
Reserved	-	444,756,083	444,756,083	(444,756,083)	-
Unreserved	12,394,577	-	12,394,577	(12,394,577)	-
Total fund balances	12,394,577	444,756,083	457,150,660	(457,150,660)	-
Total liabilities and fund balances	$ 12,946,027	450,285,647	463,231,674		
Net assets:					
Restricted for debt service				26,838,760	26,838,760
Unrestricted				12,237,414	12,237,414
Total net assets				$ 39,076,174	39,076,174

See accompanying notes to financial statements

STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES/NET ASSETS

For the year ended June 30, 2005

	General Fund	Debt Service Fund	Total	Adjustments (Note 6)	Statement of Net Assets
REVENUES:					
Investment earnings	$ 517,182	1,179,351	1,696,533	-	1,696,533
Interest income on bonds receivable	84,633	15,664,431	15,749,064	-	15,749,064
Total revenues	601,815	16,843,782	17,445,597	-	17,445,597
EXPENDITURES / EXPENSES					
Debt service:					
Principal payments	-	58,345,000	58,345,000	(58,345,000)	-
Interest payments - expense	-	15,218,639	15,218,639	982,838	16,201,477
Payments to primary government	1,177,427	-	1,177,427	-	1,177,427
Professional services	491,031	-	491,031	-	491,031
Arbitrage interest	-	-	-	-	-
Personal services	71,400		71,400	-	71,400
Printing and advertising	26,685	-	26,685	-	26,685
Administrative travel	9,970	-	9,970	-	9,970
Office expense	3,155	-	3,155	-	3,155
Miscellaneous expenses	584	-	584	-	584
Total expenditures - expenses	1,780,252	73,563,639	75,343,891	(57,362,162)	17,981,729
Excess (deficiency) of revenues over expenditures - expenses	(1,178,437)	(56,719,857)	(57,898,294)	57,362,162	(536,132)
OTHER FINANCING SOURCE/USES					
Proceeds of bonds payable	-	122,990,000	122,990,000	(122,990,000)	-
Transfers to/from Custodial Fund	(2,844,181)	2,844,181	-	-	-
Transfers - internal activities	1,474,261	(1,474,261)	-	-	-
Total other financing source/use	(1,369,920)	124,359,920	122,990,000	(122,990,000)	-
Excess (deficiency) of revenues and transfers in over expenditures - expenses and transfers out	(2,548,357)	67,640,063	65,091,706	(65,627,838)	(536,132)
FUND BALANCES / NET ASSETS					
Beginning of the year	14,942,934	377,116,020	392,058,954	(352,446,648)	39,612,306
End of the year	$ 12,394,577	444,756,083	457,150,660	(418,074,486)	39,076,174

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 ▸ HISTORY/REPORTING ENTITY

The Alaska Municipal Bond Bank Authority (Authority or Bond Bank) was created pursuant to Alaska Statute, Chapter 85, Title 44, as amended, (Act) as a public corporation and instrumentality of the State of Alaska (State), but with a legal existence independent of and separate from the State. The authority is a discretely presented component unit of the State of Alaska for purposes of financial reporting.

The Authority was created for the purpose of making moneys available to municipalities within the State to finance capital projects or for other authorized purposes by means of issuance of bonds by the Authority and use of proceeds from such bonds to purchase from the municipalities their general obligation and revenue bonds. The Authority commenced operations in August 1975.

The bonds are obligations of the Authority, payable only from revenues or funds of the Authority, and the State of Alaska is not obligated to pay principal or interest thereon, and neither the faith and credit nor the taxing power of the State is pledged to the bonds. The municipal bonds and municipal bond payments, investments thereof and proceeds of such investments, if any, and all funds and accounts established by the bond resolution to be held by the Trustee (with the exception of the Coastal Energy Loan Debt Service Program, which is administered by the Authority) are pledged and assigned for the payment of bonds.

The Authority may not issue revenue bonds in excess of $75 million in any fiscal year unless the State of Alaska Legislature approves a greater amount.

AS 44.85.180(c) was enacted in 1975, limiting Bond Bank bonds outstanding at any time to $150 million. This Statue has been periodically amended to raise the limit. In 2003, the limit was raised to $500 million. Total Bond Bank bonds and notes outstanding as of June 30, 2005 are approximately $409.4 million. Thus, the limit on additional bond issuance as of June 30, 2005 is approximately $90.6 million.

NOTE 2 ▸ SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial principles. The most significant of the Authority's accounting policies are described below.

(A) GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

The statement of net assets and the statement of changes in net assets report information on all of the activities of the Authority. For the most part, the effect of interfund activity has been removed from these statements. The balance sheet and statement of revenues, expenditures and changes in fund balances are provided for governmental funds.

(B) MEASUREMENT FOCUS, BASIS OF ACCOUNTING, AND FINANCIAL STATEMENT PRESENTATION

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 180 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures are recorded only when payment is due.

The Authority reports the following major governmental funds:

The *general fund* is the Authority's primary operating fund. It accounts for all financial resources of the Authority, except those required to be accounted for in another fund.

The *debt service fund* accounts for the resources accumulated and payments made for principal and interest on long-term debt of the Authority.

The purposes of each of these funds are described in the following paragraphs:

GENERAL FUND

The General Fund is comprised of a custodian account and an operating account. The custodian account is established to account for appropriations by the State of Alaska Legislature available to fund the special reserve account. The Operating Account is established to account for the ordinary operations of the Authority. Moneys are derived from the following sources: (a) amounts appropriated by the Legislature, (b) fees and charges collected, (c) income on investments of the Statutory Reserve Account in excess of required debt service reserves required by bond resolutions and (d) any other moneys made available for purposes of the General Fund from any other source.

Amounts in the Operating Account may be used to pay (a) administrative expenses of the Authority, (b) fees and expenses of the Trustee and paying agents, (c) financing costs incurred with respect to issuance of bonds and (d) any expenses in carrying out any other purpose then authorized by the Act. The excess revenues of the Operating Account are returned to the State of Alaska

DEBT SERVICE FUND

Within the Debt Service Fund, separate Debt Service Programs have been established for each bond resolution to account for the portion of bond sale proceeds used to purchase obligations of the municipalities and for the payment of interest and principal on all bonds of the Authority issued under the nine resolutions. Each program is comprised of an "interest account" and a "principal account", both of which are maintained by a trustee.

The receipts of interest and principal from the municipalities and the Statutory Reserve Account are deposited in these programs and are used to pay interest and principal on the Authority bonds. One additional Debt Service Program has been established to account for transactions not involving bond resolutions. This is the Coastal Energy Loan Debt Service Program. The Coastal Energy Loan Debt Service Program is not maintained by a trustee. Payments of interest and principal by municipalities having coastal energy loans are made directly to the federal government by the municipalities and are accounted for in the Coastal Energy Loan Debt Service Program.

Each debt service fund programs contains a Statutory Reserve Account established to account for (a) money available to fund debt service reserves required by future bond sales under various bond resolutions (Custodian Account) and by (b) debt service reserves which have already been established under various bond resolutions which are to be used in the case of deficiency in a Debt Service Program in accordance with its respective bond resolution (reserve accounts). Separate reserve accounts exist under each bond resolution as follows:

1976 General Bond Resolution – The amount on deposit in the reserve account is to be the greater of the maximum annual debt service requirement or 10% of all municipal loan obligations outstanding. The reserve account is comprised of an ordinary reserve sub-account and a special reserve sub-account. The ordinary reserve sub-account is created as a result of the Authority increasing each bond issue by the amount necessary to fund one-third of the required debt service reserve or with a transfer from the Custodian Account unreserved investment earnings account. The special reserve sub-account is created and funded from the Custodian Account at an amount equal to two-thirds of the required debt service reserve. Both sub-accounts are maintained by a trustee.

On August 23, 1999, the Authority amended the debt service reserve requirement for the 1976 bond resolution that takes effect when all bonds outstanding as of the date of the resolution are retired. Under this new requirement, the reserve must be the least of: (i) 10% of the original stated principal amount of all bonds outstanding; (ii) the maximum annual principal and interest requirements on all bonds then outstanding; (iii) 125% of the average principal and interest requirements on all bonds then outstanding; or (iv) such lesser amount as shall be required to maintain the exemption of interest of all bonds outstanding from inclusion in gross income for federal income tax purposes under the Internal Revenue Code.

1990 Revenue Bond Resolution – Under this resolution a special reserve account was created at an amount equal to the maximum annual debt service of municipal obligations outstanding from moneys made available by legislative appropriation residing in the Custodian Account.

1993 Revenue Bond Resolution – Under this resolution a special reserve account was created at an amount equal to the maximum annual debt service of municipal obligations outstanding from moneys made available by legislative appropriation residing in the Custodian Account.

Summary of Significant Accounting Policies continued

1995 Revenue Bond Resolution – Under this resolution a special reserve account was created at an amount equal to the maximum annual debt service of municipal obligations outstanding from moneys made available by legislative appropriation residing in the Custodian Account.

1997 Revenue Bond Resolution – Under this resolution an ordinary reserve account was created at an amount equal to the lesser of 10% of the proceeds of the 1997 Series A bonds or the maximum annual debt service on all Series 1997 A bonds outstanding under the resolution.

1998 Revenue Bond Resolution – Under this resolution a special reserve account was created at an amount equal to the maximum annual debt service of municipal obligations outstanding from moneys made available by legislative appropriation residing in the Custodian Account.

1999 Revenue Bond Resolution – Under this resolution a special reserve account was created at an amount equal to the maximum annual debt service of municipal obligations outstanding from moneys made available by legislative appropriation residing in the Custodian Account.

2000 Revenue Bond Resolution – Under this resolution a special reserve account was created at an amount equal to the maximum annual debt service of municipal obligations outstanding from moneys made available by legislative appropriation residing in the Custodian Account.

2001 Revenue Bond Resolution – Under this resolution a special reserve account was created at an amount equal to the maximum annual debt service of municipal obligations outstanding from moneys made available by legislative appropriation residing in the Custodian Account.

2002 A Revenue Bond Resolution – Under this resolution a special reserve account was created at an amount equal to the maximum annual debt service of municipal obligations outstanding from moneys made available by legislative appropriation residing in the Custodian Account.

2003 A Revenue Bond Resolution – Under this resolution a special reserve account was created at an amount equal to the maximum annual debt service of municipal obligations outstanding from moneys made available by legislative appropriation residing in the Custodian Account.

2003 B Revenue Bond Resolution – Under this resolution a special reserve account was created at an amount equal to the maximum annual debt service of municipal obligations outstanding from moneys made available by legislative appropriation residing in the Custodian Account.

2003 C Revenue Bond Resolution – Under this resolution a special reserve account was created at an amount equal to the maximum annual debt service of municipal obligations outstanding from moneys made available by legislative appropriation residing in the Custodian Account.

2004 A Revenue Bond Resolution – Under this resolution a special reserve account was created at an amount equal to the maximum annual debt service of municipal obligations outstanding from moneys made available by legislative appropriation residing in the Custodian Account.

2004 B Revenue Bond Resolution – Under this resolution a special reserve account was created at an amount equal to the maximum annual debt service of municipal obligations outstanding from moneys made available by legislative appropriation residing in the Custodian Account.

Amounts in the Statutory Reserve Account in excess of (a) required debt service reserves, (b) appropriations by the legislature residing in the Custodian Account, and (c) income on non-legislature-appropriated funds are transferred to the Operating Account. Income on non-legislature-appropriated funds, representing excess of revenues over expenditures of the ordinary reserve accounts and interest earned on the unreserved investment earnings account is accumulated in the Custodian Account and is available to fund the Special Reserve account.

(C) RESTRICTED ASSETS

Certain resources set aside for the repayment of the Authority's bonds, net of certain proceeds from additional bonds issued, are classified as restricted net assets on the statement of net assets because they are maintained in separate trust accounts and their use is limited by applicable bond covenants. Cash and cash equivalents and investments include $26,838,760 of restricted assets. These assets were funded from the issuance of $9,762,500 of reserve bonds and a transfer of $18,601,414 of State appropriation.

(D) LONG-TERM OBLIGATIONS

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the statement of net assets.

(E) FUND EQUITY

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. In the government-wide financial statements, restrictions of net assets are reported when externally imposed.

(F) INTEREST ARBITRAGE REBATE

Bonds issued after August 15, 1986 are subject to Internal Revenue Service income tax regulations which require rebates to the U.S. Government of interest income earned on investments purchased with the proceeds from the bonds or any applicable reserves in excess of the allowable yield of the issue.

(G) INCOME TAXES

The Authority is exempt from paying federal and state income taxes.

NOTE 3 ▸ CASH

The Authority considers all highly liquid investments purchased with an original maturity of three months or less at the date of purchase to be cash equivalents. Cash and cash equivalents at June 30 consist of demand deposits with various financial institutions.

The bank balance of all of the Authority's deposits with financial institutions are insured by the FDIC or collateralized by securities held in the Authority's name by its custodial agent. At June 30, 2005, the amounts recorded in the Authorities books equaled its bank balances.

NOTE 4 ▸ INVESTMENTS

The fair value as of June 30, 2005 of the Authority's investments is $47,600,552. At June 30, 2005 the investments held in the reserve accounts total $37,985,705 and the Custodian account totals $9,614,847.

The fair value as of June 30, 2005 of debt security investments by contractual maturity is shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalty.

	Investment Maturities (in Years)				
	Less than 1	1-5	6-10	More than 10	Total
U.S. Treasury securities	$ 2,686,175	12,010,891	-	485,000	15,182,066
U.S. Government agencies securities	14,184,819	16,150,860	504,345	1,577,962	32,418,486
Total investments	$ 16,870,994	28,161,751	504,345	2,062,962	47,600,552

(A) INVESTMENT POLICIES

The Authority has distinct investment objectives and policies associated with the Custodian Account, Reserve Funds, and municipal debt payments. The three classes of funds are listed below:

- Custodian Account – The Custodian Account investment portfolio is designed with the objective of attaining the highest market rate of return subject to the required use of the Custodian Account for operation, funding transfers to the state, and funding reserves. When the Custodian Account balance allows, a longer investment horizon is implemented for the Custodian Account, accepting the limited probability of short-term loss in exchange for higher yield on investments. The Custodian Account balance must exceed $15 million, and be forecast to exceed $15 million for the subsequent six month period before return on investment will be the highest priority of the Custodian Account. The Custodian Account has to maintain sufficient liquidity to meet operating requirements, provide the prior fiscal year's state dividend, and to allow transfers to reserves as needed for bond issuance activity. Long term preservation of principal is the third objective of the Custodian Account's investment program. Investments shall be undertaken in a manner that minimizes the probability of long-term loss.

NOTES TO FINANCIAL STATEMENTS, CONTINUED

Investment Policies, continued

- The Custodian Account balance is a critical component in determining anticipated life, ability to diversify, and investment policy in this account. Accordingly, when the account balance is above $15 million a more aggressive policy will be implemented. When the account balance is below $15 million a more conservative policy will be used.
- Shifting from one asset allocation to another may be approved by the investment committee.
- There are no arbitrage restrictions.
- When the Custodian Account balance is less than $15 million:
  - 100% government agencies and U.S. Treasuries with maturities of less than 5 years.
  - Performance benchmark is 100% Merrill Lynch 1-5 Government Index.
- When the Custodian Account balance exceeds and is expected to remain in excess of $15 million:
  - 10% Money Market Fund.
  - 90% Broad U.S Bond Market Fund.
  - Performance benchmark is 10% Three-month U.S. Treasury Bill and 90% Lehman Brothers Aggregate Index.
- The following transactions are prohibited with the Custodian Account unless those transactions have the prior written consent of the Investment Committee:
  - Short sale of securities (the sale and settlement of a security not currently owned by the Authority and a formal agreement to borrow the security to facilitate the settlement of the short sale);
  - Purchases of futures, forwards or options for the purpose of speculating (currency futures, forwards and options are permitted only for hedging or to facilitate otherwise permissible transactions);
  - Borrowing to leverage the return on investments. Extended settlement of securities purchases executed to facilitate or improve the efficiency of a transaction will not be considered borrowing, provided that sufficient cash equivalent securities or receivables are available to facilitate the extended settlement;
  - Purchases of "private placement" or unrated corporate bonds;

- Bond Reserve Funds — Preservation of Principal is the foremost objective of the Reserve Funds investment program. These Funds shall be managed to ensure that the corpus is preserved. These Funds will not be expended until the final maturity of the bond issue they secure, unless there is a failure to pay debt service by a community. As there is limited benefit in maximizing return it is the least important objective of

the Reserve Funds. It is anticipated that the Reserve Funds cumulative average return should target the blended arbitrage yield limit of the bond issues secured.

- Bond Resolutions limit allowed investment of these funds. Investment risk should be examined on an annual basis to ensure that no greater than the minimum level of risk required to achieve the highest probability of earning the arbitrage yield limit on the bonds is incurred.
- 100% government agencies and U.S. Treasuries with maturities of less than 5 years.
- Performance benchmark is 100% Merrill Lynch 1-5 Government Index.

- Municipal Debt Payments — Preservation of Principal and liquidity are the foremost objectives of the Municipal Debt Payments investment program, as these funds will be expended within seven business days of receipt. Return on investment is a benefit of holding these funds for the advance payment period, but not the focus of investing the funds. The bond resolutions limit investments.
  - 100% Money Market Fund.
  - Performance benchmark is 10% Three-month U.S. Treasury Bill.

It is the policy of the Authority to diversify its investments and to ensure the safety and liquidity of the investments by observing the following sound investment practices:

- Not more than 5% of the Custodian Account may be invested in the corporate debt of any one issuer, at the time of purchase.
- In the event of a credit downgrade which reduces a security below the required rating written notification will be made to the Investment Committee setting forth the particulars of the downgrade and recommending a course of action.
- Not more than 50% of the Custodian Account may be invested in corporate securities, at the time of purchase.
- The duration of the Custodian Account must remain within 80 to 120 percent of the duration of the Lehman Brothers Aggregate Index.
- Purchases of more than 10% of a corporate bond issue shall not be made.

(B) CONCENTRATION RISK

Concentration risk is the risk of loss attributed to the magnitude of the Authority's investment in a single issuer. Concentration limits are not established in the bond indentures and governing agreements for pledged investments. The Authority's policies set out maximum concentration limits for investments managed by the external investment manager.

(C) CREDIT RISK

Credit risk is the risk of loss due to the failure of the security or backer. The Authority mitigates its credit risk by limiting investments permitted in the investment policies. The credit quality ratings of the Authority's investments are AAA and Aaa as of June 30, 2005 as described by nationally recognized statistical rating organization Standard and Poor, and Moody's, respectively.

NOTES TO FINANCIAL STATEMENTS, CONTINUED

U.S. Treasury securities and securities of agencies that are explicitly guaranteed by the U.S. government total $47,600,552, and are not considered to have credit risk.

(D) CUSTODIAL CREDIT RISK

The Authority assumes levels of custodial credit risk for its deposits with financial institutions, bank investment agreements, and investments. For deposits, custodial credit risk is the risk that, in the event of a bank failure, the Authority's deposits may not be returned. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Authority will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The Authority has not established a formal custodial credit risk policy for its investments.

The Authority had no investments registered in the name of a counterparty.

(E) INTEREST RATE RISK

Interest rate risk is the risk that the market value of investments will decline as a result of changes in general interest rates. For non-pledged investments, the Authority mitigates interest rate risk by structuring its investment's maturities to meet cash requirements, thereby avoiding the need to sell securities in the open market prior to maturity. For investments held in trust, investment maturities are structured to meet cash requirements as outlined in its bond indentures and contractual and statutory agreements.

(F) MODIFIED DURATION

Modified duration estimates the sensitivity of an investment to interest rate changes. The following table shows the Authority's investments with their weighted average modified duration as of June 30, 2005 by investment type:

	Investment Fair Value	Modified Duration
U.S. Treasury securities	$ 15,182,066	3.08
U.S. Government agencies securities	32,418,486	3.85
Total Portfolio	$ 47,600,552	3.60

The Authority's investment policies require the duration of the Custodian Account must remain within 80 to 120 percent of the duration of the Lehman Brothers Aggregate Index.

NOTE 5 ▸ BOND AND NOTES RECEIVABLE

Bonds and notes receivable by debt service program at June 30, 2003 mature in varying annual installments as follows:

Year ending June 30	1976 General	1995A Seward Revenue	1997A Ketchikan Revenue	1998B Ketchikan Revenue	1998B Homer Revenue	1999A Inter-Island Ferry Revenue
2006	$ 19,820,500	170,000	690,000	660,000	235,000	75,000
2007	18,025,000	180,000	725,000	685,000	250,000	80,000
2008	17,000,000	195,000	760,000	715,000	255,000	85,000
2009	16,905,000	205,000	800,000	755,000	180,000	85,000
2010	17,115,000	215,000	840,000	785,000	185,000	90,000
2011-2015	78,788,000	1,300,000	4,930,000	2,370,000	-	535,000
2016-2020	71,589,000	-	3,665,000	-	-	710,000
2021-2025	46,035,000	-	-	-	-	-
2026-2030	8,800,000	-	-	-	-	-
2031 and after	-	-	-	-	-	-
	$294,157,500	2,265,000	12,410,000	6,170,000	1,105,000	1,660,000

Year ending June 30	2000A Unalaska Revenue	2000B Seward Revenue	2001A Ketchikan Revenue	2001B Ketchikan Revenue	2002A Ketchikan Revenue	2003A CBJ Revenue
2006	$ 445,000	105,000	80,000	125,000	460,000	1,445,000
2007	-	110,000	85,000	120,000	475,000	1,490,000
2008	-	115,000	90,000	130,000	490,000	-
2009	-	120,000	90,000	135,000	505,000	-
2010	-	125,000	95,000	140,000	520,000	-
2011-2015	-	745,000	555,000	825,000	2,930,000	-
2016-2020	-	930,000	555,000	820,000	-	-
2021-2025	-	435,000	-	-	-	-
2026-2030	-	-	-	-	-	-
2031 and after	-	-	-	-	-	-
	$ 445,000	2,725,000	1,550,000	2,295,000	5,380,000	2,935,000

Year ending June 30	2003B Valdez Revenue	2003C Kodiak Revenue	2004A CBJ Revenue	2004B Anchorage Revenue	Coastal Energy Loan	Total Principal
2006	-	200,000	-	110,000	5,400,000	30,010,000
2007	665,000	200,000	500,000	95,000	400,000	24,085,000
2008	675,000	205,000	515,000	100,000	400,000	21,730,000
2009	680,000	215,000	535,000	100,000	400,000	21,710,000
2010	680,000	-	555,000	105,000	450,000	21,905,000
2011-2015	5,005,000	-	3,120,000	600,000	2,250,000	104,153,000
2016-2020	6,600,000	-	3,875,000	730,000	1,705,878	91,199,878
2021-2025	4,695,000	-	4,995,000	905,000	-	57,085,000
2026-2030	-	-	6,460,000	1,145,000	-	16,485,000
2031 and after	-	-	8,290,000	1,475,000	-	9,765,000
	$ 19,000,000	820,000	28,845,000	5,365,000	11,005,878	398,123,378

NOTES TO FINANCIAL STATEMENTS, CONTINUED

The general fund includes $150,000 of 7.9% bonds receivable due from the City of Haines that mature through 2009, and $710,000 of 6.9% bonds receivable due from the City of Yakutat that mature through 2014.

Under the Coastal Energy Loan Program (Program), the Authority issued $5,000,000 1986 Series A Coastal Energy Bonds (Bonds) payable to the National Oceanic and Atmospheric Administration (NOAA). The proceeds of these bonds were used to purchase port revenue bonds from the City of Nome. The City of Nome entered into a tripartite agreement with NOAA and the Authority effective August 2, 1994 to defer payment of the principal and accrual of interest for ten years. The related loan payable does not represent a general obligation of the Authority as it is payable only from proceeds received from the City of Nome.

Also under the Program, the Authority issued $6,563,000 1987 Series A Coastal Energy Bonds payable to NOAA. The proceeds of these bonds were used to purchase port revenue bonds from the City of St. Paul. The City of St. Paul entered into a tripartite agreement with NOAA and the Authority effective December 14, 2000 to modify and amend the repayment terms including principal and interest.

The related loan payables do not represent a general obligation of the Authority as they are payable only from proceeds received from the City of Nome and St. Paul, respectively. Payment of principal and interest on the Bond Bank's Coastal Energy Bond is not secured by a pledge of any amounts held by or payable to the Bond Bank under the General Bond Resolution, including the Reserve Account, and is not in any way a debt or liability of the Bond Bank.

NOTE 6 ▸ LONG TERM LIABILITIES

ISSUE	Debt Service Account		Statutory Reserve Account Ordinary Reserve Sub-Account	
	Interest Rate	Principal Outstanding	Interest Rate	Principal Outstanding
1976 General Bond Resolution Program				
1995 Series A	4.5%–7%	$ 1,590,000	4.5%–7%	$ 240,000
City of Haines				
Kenai Peninsula Borough				
1995 Series C – Lake and Peninsula Borough	5%–6%	550,000	6%	510,000
1995 Series D – City of Palmer	5%–6%	90,000	–	–
1996 Series A	4%–5.5%	610,000	–	–
City of Hoonah				
City of Soldotna				
1996 Series B	4.5%–6.75%	695,000		
City of Seward				
1997 Series A	5%–5.4%	185,000	–	–
Lake & Peninsula Borough				
City of Yakutat				
1997 Series B – City of Ketchikan	4.5%–6%	1,435,000	–	–
1998 Series A		6,400,000	5%	100,000
City of Wasilla	4.63%–6%			
Aleutians East Borough	4.63%–5.63%			
1998 Series B		1,830,000	–	–
City of Homer	4%–4.375%			
City of Cordova	4%–4.75%			
1999 Series A	4.375%–5.5%	9,685,000	4.375%–5.5%	360,000
City of Sitka				
Aleutians East Borough				

Long Term Liabilities, continued

ISSUE	Debt Service Account		Statutory Reserve Account Ordinary Reserve Sub-Account	
	Interest Rate	Principal Outstanding	Interest Rate	Principal Outstanding
2000 Series A	5.5%–5.875%	2,830,000	–	–
City of Fairbanks				
City of Cordova				
2000 Series B	4.8%–6%	2,960,000	–	–
City of Kaktovik				
City of Sitka				
City of Unalaska				
2000 Series C – Northwest Arctic Borough	4.53%–5.75%	6,360,000	–	–
2000 Series D – Petersburg	4.55%–5.70%	1,580,000	–	–
2000 Series F	4.75%–5.375%	10,577,000	5%–5.375%	473,000
Kenai				
Kodiak Island Borough				
Lake and Pen-Port				
Wrangell				
Nome–School				
2000 Series F – Kodiak Island Borough	6.9%–9%	510,000	–	–
2001 Series A – Northwest Arctic Borough	4.4%–5%	13,850,000	4.4%–5%	420,000
2001 Series B – Aleutians East Borough	3.875%–4.75%	3,195,000	3.875%–4.75%	285,000
2002 Series A – City of Wasilla	2.5%–4.5%	13,715,000	2.5%–4.5%	755,000
2002 Series B	3.875%–4.80%	10,530,000	3.875%–4.80%	525,000
City of Wrangell				
Northwest Arctic Borough				
2003 Series A – Ketchikan Gateway Borough	3.70%–4.80%	5,440,000	4.80%	305,000
2003 Series B – Kodiak Island Borough	2.00%–4.75%	2,035,000	–	–
2003 Series C	2.00%–3.625%	6,590,000	2.00%–3.625%	210,000
Kenai Peninsula Borough				
Lake & Peninsula Borough				
2003 Series D	4.90%–6.00%	400,000	4.90%–6.00%	265,000
2003 Series E	2.00%–5.25%	425,000	–	–
Aleutians East Borough				
Kenai Peninsula Borough				
2003 Series F – Seward	2.00%–3.5%	1,690,000	–	–
2003 Series G – NW Arctic Borough	2.00%–5.00%	22,825,000	–	–
2004 A Series	3.00%–4.40%	5,490,000	3.00%–4.40%	800,000
Fairbanks				
Sitka				
2004 B Series	2.00%–4.00%	16,358,500	2.00%–4.00%	331,500
Nome				
Valdez				
Petersburg				
Craig				
Seward				
2004 C Series	4.00%–5.00%	4,307,000	5.00%	258,000
Kodiak Island Borough				
Palmer				
Petersburg				
2004 D Series	3.00%–5.00%	22,550,000	3.00%	1,375,000
Adak				
Kodiak Island Borough				
2005 A Series		27,180,000	2.75%–5.00%	1,475,000
Cordova	2.75%–5.00%			
Fairbanks	2.75%–5.00%			
Ketchikan Gateway Borough	2.75%–5.00%			
Northwest Arctic Borough	2.75%–5.00%			
Sitka	2.50%–4.25%			
Unalaska	2.50%–4.25%			

NOTES TO FINANCIAL STATEMENTS, CONTINUED

ISSUE	Debt Service Account		Statutory Reserve Account Ordinary Reserve Sub-Account	
	Interest Rate	Principal Outstanding	Interest Rate	Principal Outstanding
2005 B Series		27,160,000	5.00%	465,000
Haines	4.00%–5.00%			
Ketchikan Gateway Borough	3.00%–5.25%			
City of North Pole	3.00%–5.25%			
Palmer	3.00%–5.00%			
Sitka	3.00%–5.25%			
Total 1976 General Bond Resolution Fund		294,157,500		9,762,500
1995A Seward Revenue Bond Resolution Program	4.85%–7.35%	2,263,000	-	-
1997A Ketchikan Revenue Bond Resolution Program	4.9%–5.75%	12,410,000	4.9%–5.75%	1,525,000
1998A Ketchikan Revenue Bond Resolution Program	4%–4.7%	6,170,000	-	-
1998B Homer Revenue Bond Resolution Program	4%–4.5%	1,105,000	-	-
1999A Inter-Island Ferry Revenue Bond Resolution Program	5.125%–5.9%	1,660,000	-	-
2000A Unalaska Revenue Bond Resolution Program	4.9%–5.75%	445,000	-	-
2000B Seward Revenue Bond Resolution Program	4.35%–5.5%	2,725,000	-	-
2001A Ketchikan Revenue Bond Resolution Program	4.3%–4.9%	1,550,000	-	-
2001B Ketchikan Revenue Bond Resolution Program	4.3%–4.9%	2,255,000	-	-
2002A Ketchikan Revenue Bond Public Utilities	3.00%–5.00%	5,380,000	-	-
2003A CBJ Revenue Bond Resolution Program	2.00%–3.00%	2,935,000	-	-
2003B City of Valdez Bond Resolution Program	2.75%–5.25%	19,000,000	-	-
2003C City of Kodiak Bond Resolution Program	2.00%–3.00%	820,000	-	-
2004A City and Borough of Juneau Bond Resolution Program	6.25%–4.475%	28,845,000	-	-
2004B Anchorage Bond Resolution Program	4.00%–4.75%	5,365,000	-	-
Total Revenue Bonds		92,960,000		1,525,000
Coastal Energy Reserve Loan Account				
City of North Pole Facility Revenue Bond	5.50%	5,000,000	-	-
City of Saint Paul—Fuel Dock	5%	6,005,878	-	-
Total Coastal Energy Reserve Loan Account		11,005,878		-
		$ 398,124,378		11,287,500

During the year ended June 30, 2005 the Authority's long—term liabilities changed as follows:

	Beginning of year	New debt	Repayments	End of year
General obligation bonds payable	$ 267,825,000	88,780,000	52,685,000	303,920,000
Revenue bonds payable	63,905,000	34,210,000	5,630,000	94,485,000
Other long-term debt	11,035,878	-	30,000	11,005,878
Total	$ 344,765,878	122,990,000	58,345,000	409,410,878

General obligation bonds are secured by bonds receivable and by amounts in the ordinary reserve account. The Act further provides that if a municipality defaults on its principal and/or interest payments, upon written notice by the Authority, the State of Alaska must pay to the Authority all funds due from the defaulting municipality from the State in an amount sufficient to clear the default. Loans made under the Coastal Energy Loan Program are payable only from proceeds received from the municipalities to which the loans were made.

The above bonds mature in varying annual installments. The maturities at June 30, 2005 are as follows:

Year ending June 30	– 1976 – General	– 1976 – Reserve	1995A Seward Revenue	1997A Ketchikan Revenue	General Reserve	1998A Ketchikan Revenue	1998B Homer Revenue
2006	$ 19,820,500	1,874,500	170,000	690,000	-	660,000	235,000
2007	18,025,000	1,155,000	180,000	725,000	-	685,000	250,000
2008	17,000,000	800,000	195,000	760,000	-	715,000	255,000
2009	16,905,000	75,000	205,000	800,000	-	755,000	180,000
2010	17,115,000	5,000	215,000	840,000	-	785,000	185,000
2011-2015	78,788,000	2,287,000	1,300,000	4,930,000	-	2,570,000	-
2016-2020	71,589,000	1,006,000	-	3,665,000	1,525,000	-	-
2021-2025	46,035,000	2,560,000	-	-	-	-	-
2026-2030	8,880,000	-	-	-	-	-	-
2031 and after	-	-	-	-	-	-	-
	$ 294,157,500	9,762,500	2,265,000	12,410,000	1,525,000	6,170,000	1,105,000

Year ending June 30	1999A Inter-Island Ferry Revenue	2000A Unalaska Revenue	2000B Seward Revenue	2001A Ketchikan Revenue	2002B Ketchikan Revenue	2002A Ketchikan Revenue	2003A CBJ Revenue
2006	75,000	445,000	105,000	80,000	115,000	460,000	1,445,000
2007	80,000	-	110,000	85,000	120,000	475,000	1,490,000
2008	85,000	-	115,000	90,000	130,000	490,000	-
2009	85,000	-	120,000	90,000	135,000	505,000	-
2010	90,000	-	125,000	95,000	140,000	520,000	-
2011-2015	535,000	-	745,000	555,000	825,000	2,930,000	-
2016-2020	710,000	-	950,000	555,000	820,000	-	-
2021-2026	-	-	435,000	-	-	-	-
2026-2030	-	-	-	-	-	-	-
2031 and after	-	-	-	-	-	-	-
	$ 1,660,000	445,000	2,725,000	1,550,000	2,285,000	5,380,000	2,935,000

Year ending June 30	2003B Valdez Revenue	2003C Kodiak Revenue	2004A CBJ Revenue	2004B Anchorage Revenue	Coastal Energy Loan	Total Principal	Total Interest
2006	-	200,000	-	110,000	3,400,000	31,885,000	17,960,479
2007	665,000	200,000	300,000	95,000	400,000	25,240,000	16,398,854
2008	675,000	205,000	315,000	100,000	400,000	22,530,000	15,696,521
2009	680,000	215,000	335,000	100,000	400,000	21,785,000	14,826,328
2010	680,000	-	355,000	105,000	450,000	21,905,000	13,947,354
2011-2015	3,005,000	-	3,120,000	600,000	2,250,000	106,440,000	55,656,371
2016-2020	6,600,000	-	3,875,000	730,000	1,705,878	93,730,878	33,431,444
2021-2025	4,695,000	-	4,995,000	905,000	-	59,645,000	13,399,601
2026-2030	-	-	6,460,000	1,145,000	-	16,485,000	4,526,241
2031 and after	-	-	8,290,000	1,475,000	-	9,765,000	1,476,625
	$ 19,000,00	820,000	28,545,000	5,365,000	11,005,878	409,410,878	187,519,818

NOTES TO FINANCIAL STATEMENTS, CONTINUED

NOTE 7 ▸ ADJUSTMENTS

Certain adjustments are considered to be necessary to the governmental funds in order to present the Authority's financial position and the results of its operations. These adjustments include the elimination of inter-fund payables and receivables. Additionally, bond proceeds are reported as financing sources in governmental funds and thus contribute to the change in fund balance. In the statement of net assets, however, issuing debt increases long-term liabilities and does not affect the statement of activities. Similarly, repayment of principal is an expenditure in the governmental funds, but reduces the liability in the statement of net assets.

NOTE 8 ▸ COMMITMENTS

In fiscal year 2006, $250,000 in earnings from the Custodian Account will be transferred to the State of Alaska and deposited in the State's Debt Service Fund. The entire Custodian Account balance is available for appropriation, at any time, by the State Legislature.

NOTE 9 ▸ SUBSEQUENT EVENT

Subsequent to June 30, 2005, the Bond Bank issued two general obligation bond series to follow:

General Obligation Bonds, 2005 Series C, in the face amount of $32,060,000 with interest rates ranging from 4.0% to 5.00% over maturities of October 1, 2006 through October 1, 2025.

General Obligation Bonds, 2005 Series One, in the face amount of $18,450,000, sold in October 2005. Interest rates ranging from 3.00% to 5.25% over maturities of June 1, 2006 through June 2025.

In September 2005, $250,000 in earnings from the Custodian Account was transferred to the State of Alaska and deposited in the State's Debt Retirement Fund.

City of Nome and St. Paul have entered in negotiations, with NOAA, for the restructuring and possible forgiveness for their respective Coastal Energy loans. The related loan payables do not represent a general obligation of the Authority, as they are payable only from proceeds received from the City of Nome and St. Paul, respectively. Payment of principal and interest on the Bond Bank's Coastal Energy Bond is not secured by a pledge of any amounts held by or payable to the Bond Bank under the General Bond Resolution, including the Reserve Account, and is not in any way a debt or liability of the Bond Bank. Loan payments due in August 2005 have not been made.

THE BOND BANK

An Idea That Works

SUPPLEMENTAL SCHEDULE OF STATUTORY RESERVE ACCOUNTS – ASSETS, LIABILITIES AND ACCOUNT RESERVES

For the year ended June 30, 2005

	1976 General "Ordinary"	1976 Special	1990A Yakutat	1995A Seward	1997A Ketchikan
ASSETS					
Cash	$ 1,209,148	194,219	-	2,685	20,531
Accrued interest receivable	32,714	207,221	-	5,106	14,200
Marketable securities	8,495,264	20,149,168	-	297,083	1,508,623
Interaccount receivables	1,027,439	408,407	-	-	-
	10,764,565	20,959,015	-	304,874	1,543,354
LIABILITIES					
Interaccount payables	847,180	2,416,267	-	4,517	95,265
Bond payable	9,762,500	-	-	-	1,525,000
Accrued interest payable	133,299	-	-	-	6,831
	10,742,979	2,416,167	-	4,517	1,627,096
RESERVES					
Special Reserve – State Appropriated	-	15,665,302	-	299,550	-
Special Reserve – Unappropriated	-	2,944,602	-	-	-
Special Reserve – Unrealized Gain (Loss)	-	(65,056)	-	807	-
Ordinary Reserve – Unallocated	121,570	-	-	-	(74,765)
Ordinary Reserve – Unrealized Gain (Loss)	(99,984)	-	-	-	(8,977)
	21,586	18,542,848	-	300,357	(83,742)
	$ 10,764,565	20,959,015	-	304,874	1,543,354

	1998A Ketchikan	1998B Homer	1999A Inter-Island	2000A Unalaska	2000B Seward
ASSETS					
Cash	$ 37,203	10,284	22,707	22,288	27,839
Accrued interest receivable	30,338	5,710	458	688	688
Marketable securities	1,271,667	242,023	149,438	224,156	224,156
Interaccount receivables	4,542	-	-	-	2,893
	1,363,750	258,016	172,603	247,132	255,576
LIABILITIES					
Interaccount payables	20,083	5,727	6,394	9,523	2,931
Bond payable	-	-	-	-	-
Accrued interest payable	-	-	-	-	-
	20,083	5,727	6,394	9,523	2,931
RESERVES					
Special Reserve – State Appropriated	1,341,299	251,396	169,804	243,000	248,518
Special Reserve – Unappropriated	-	-	-	-	-
Special Reserve – Unrealized Gain (Loss)	2,368	893	(3,595)	(5,391)	4,127
Ordinary Reserve – Unallocated	-	-	-	-	-
Ordinary Reserve – Unrealized Gain (Loss)	-	-	-	-	-
	1,343,667	252,289	166,209	237,609	252,645
	$ 1,363,750	258,016	172,603	247,132	255,576

See Independent Auditors' Report

SUPPLEMENTAL SCHEDULE OF STATUTORY RESERVE ACCOUNTS – ASSETS, LIABILITIES AND ACCOUNT RESERVES

For the year ended June 30, 2005

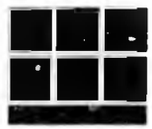
	2001A Ketchikan	2001B Ketchikan	2002A Ketchikan	2003A CBJ	2000B Valdez
ASSETS					
Cash	$ 32,174	33,764	36,300	22,872	16,268
Accrued interest receivable	382	611	805	1,594	20,256
Marketable securities	124,531	199,250	597,750	544,767	1,749,879
Interaccount receivables	-	-	-	-	9,407
	157,087	233,625	634,855	569,233	1,795,830
LIABILITIES					
Interaccount payables	5,407	8,547	24,231	6,691	-
Bond payable	-	-	-	-	-
Accrued interest payable	-	-	-	-	-
	5,407	8,547	24,231	6,691	-
RESERVES					
Special Reserve – State Appropriated	154,675	229,870	-	-	-
Special Reserve – Unappropriated	-	-	625,000	568,500	1,780,063
Special Reserve – Unrealized Gain (Loss)	(2,995)	(4,792)	(14,376)	(5,958)	15,767
Ordinary Reserve – Unallocated	-	-	-	-	-
Ordinary Reserve – Unrealized Gain (Loss)	-	-	-	-	-
	151,680	225,078	610,624	562,542	1,795,830
	$ 157,087	233,625	634,855	569,233	1,795,830

	2003C Kodiak	2004A CBJ	2004B Anchorage	Total
ASSETS				
Cash	$ 26,773	34,369	44,671	1,814,317
Accrued interest receivable	211	7,385	607	328,974
Marketable securities	74,039	1,836,124	297,787	37,985,705
Interaccount receivables	283	-	-	1,452,971
	101,306	1,878,078	343,065	41,581,967
LIABILITIES				
Interaccount payables	56	16,349	3,673	3,472,741
Bond payable	-	-	-	11,287,500
Accrued interest payable	-	-	-	140,130
	56	16,349	3,673	14,900,371
RESERVES				
Special Reserve – State Appropriated	-	-	-	18,601,414
Special Reserve – Unappropriated	101,500	1,875,750	341,931	8,237,346
Special Reserve – Unrealized Gain (Loss)	(250)	(14,021)	(2,536)	(95,008)
Ordinary Reserve – Unallocated	-	-	-	46,805
Ordinary Reserve – Unrealized Gain (Loss)	-	-	-	(108,961)
	101,250	1,861,729	339,395	26,681,596
	$ 101,306	1,878,078	343,068	41,581,967

See Independent Auditors' Report

Pension Obligation Bonds

Mark Prussing, Vice President
Lindsay Sovde, Vice President
(206) 628-2882



SEATTLE-NORTHWEST
SECURITIES CORPORATION

Replacement Obligation

What is a Pension Obligation Bond?

- A pension obligation bond is a financing used to defray unfunded pension costs.
- Pension systems measure assets on hand against the present value of projected liabilities over the long term.
- If liabilities exceed assets, the difference is known as the "Unfunded Accrued Actuarial Liability" or "UAAL."
- With lagging investment returns, increases in healthcare costs, and actuarial revaluations, many public and private pension systems have found themselves significantly under-funded.

SEATTLE-NORTHWEST SECURITIES CORPORATION

What is a Pension Obligation Bond?

- Repayment of the UAAL is amortized over a fixed period and built into payroll rates at a given interest rate, 8.25 percent in Alaska.
- Retirement system thereby becomes the "banker" for the shortfall, as employers repay the loan over the amortization period.
- Many jurisdictions have used Pension Obligation Bonds to refinance these "loans" at rates lower than the amortization rate.

Why Might Pension Obligation Bonds be Useful in Alaska

- According to the recently released 2004 valuation, assuming above-average growth in population:
  - PERS rates rise to **32% of payroll** beginning in 2011, and do not decline until 2029.
  - TRS rates rise to **50% of payroll** in 2011 and continue increasing to 56% by 2028 before declining.
- Properly structured pension obligation bonds can be an effective tool for immediately reducing payroll rates and producing long term savings for jurisdictions.
- In Oregon, jurisdictions are projected to save over $1.3 billion from use of this technique.

Alaska Pension System *

	Alaska	
	PERS	TRS
Asset base	$ 8.2 billion	$ 3.9 billion
Covered Employees	69,135	21,220
Average employer rate	16.77% (1) 25.63%	21.00% (2) 38.85%
Funded ratio	72.00%	64.00%
UAAL as of 2004 valuation	$ 3.4 billion	$2.3 billion

*As of June 30, 2004.

(1) Effective for Fiscal Year 2006, Actuarially computed at 25.63%. PERS

(2) Effective for Fiscal Year 2006, Actuarially computed at 38.85%. TRS

SEATTLE-NORTHWEST SECURITIES CORPORATION

Arbitrage play

The Arbitrage Issue

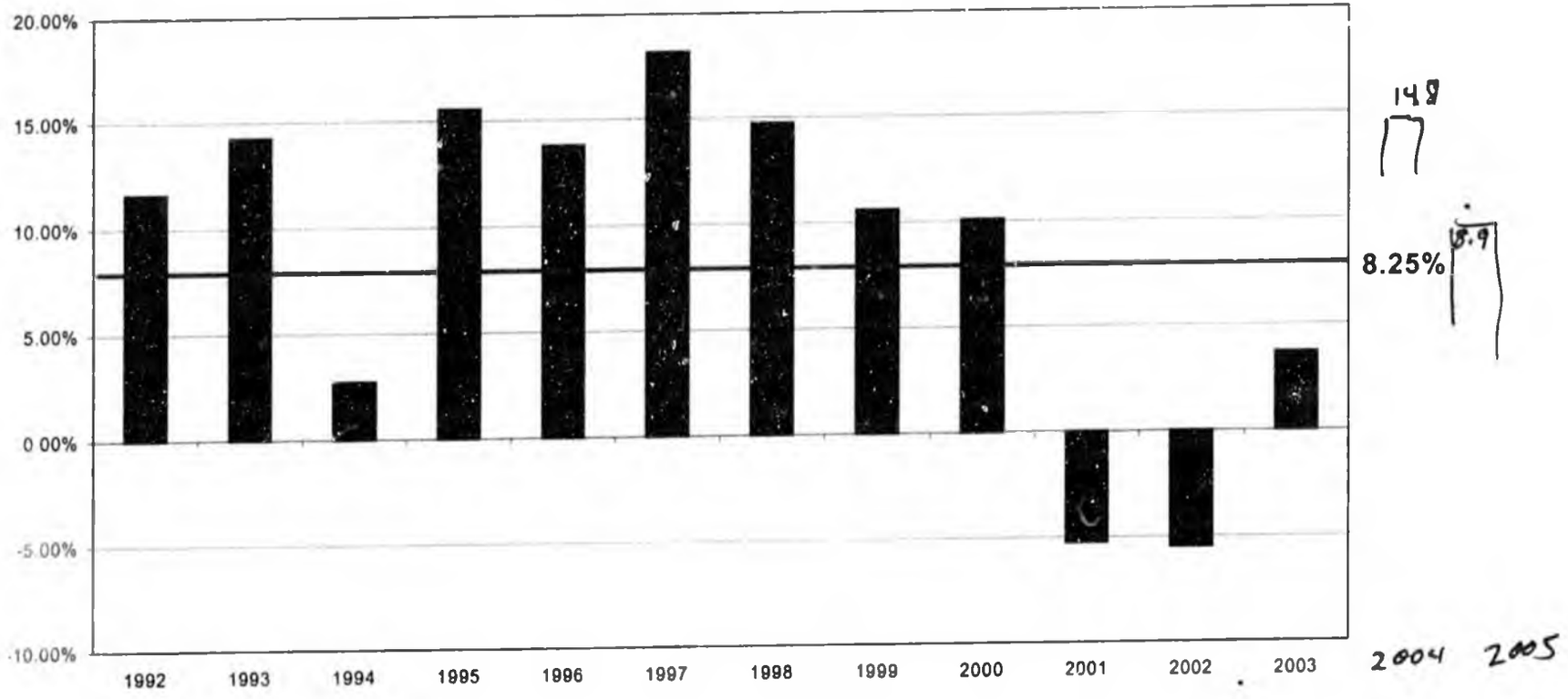
Issuing a pension bond is not like refinancing your mortgage…

- Success from borrowing depends on the market returning more than the cost of the bond.
  - For Alaska borrowers, if investment returns equal 8.25% over 25 year period over the life of the bonds, costs will be reduced as estimated.
  - If returns are greater than 8.25%, cost reductions will be greater than projected.
  - If returns are less than 8.25% cost reductions will be positive, but less than projected.
  - If returns are less than the bond yield, borrowers will be worse off than those who do not borrow.

Alaska PERS

Alaska Public Retirement System

History of Investment Results



SEATTLE-NORTHWEST SECURITIES CORPORATION

Bonding a Popular Tool

Many jurisdictions throughout the country have chosen to finance PERS liabilities with bonds.

Oregon example:

- A total of 133 school districts, cities, counties and the State have issued $5.4 billion of pension bonds in Oregon.
- Savings projected at $1.3 billion overall, assuming an 8.00% rate of return.
- Original statutory authority provided to local governments and school districts in 2001 for issuance of "full faith and credit obligations."
- School Districts also granted authority to enter into intercept agreement with the State, whereby operating funds were additionally pledged. This approach resulted in "State" credit rating.
- State Constitutional amendment approved by voters in 2003 authorizing the State to issue GO bonds for its share of the liability. Voter approval margin was 55.25%.

Oregon Process

- Bond proceeds are placed in a "lump sum account" for benefit of employer. Earnings and losses directly accrue to that account.
- Lump sum account is used to provide prepayment credit on payroll rates charged to jurisdictions.
- Although bonds have to be sold on taxable basis, interest rates for most borrowings have been well under 6%.
- Oregon State Treasury regression analysis conducted in July 2003 projected probability of positive arbitrage in PERS refinancing at nearly 90%.

Recent Returns – Oregon Lump Sum Accounts

Issuer	Par	TIC	Total Return	Annualized
Series 2002 A&B - Local Governments	$ 238 m	7.00%	43.04%	11.74% (1)
Series 2002 - School Districts	$ 775 m	5.60%	59.01%	19.14%
Series 2003 - Schools, Community Colleges	$ 1,080 m	5.73%	51.88%	20.08%
Series 2004 - Schools, Community Colleges	$ 400 m	5.49%	23.51%	13.44%
Series 2004- Local Governments	$ 126 m	6.11%	24.28%	16.19%

(1) As of November 30, 2005

Lessons Learned

1. Payment to PERS does NOT guarantee UAAL will be paid off in full.

2. Changes in size of UAAL
   - Judicial, legislative, regulatory or investment activities can cause future changes to UAAL. Further increases would continue to be responsibility of jurisdiction.
     - Reductions: Lump sum payment would put jurisdiction in surplus. Funds will not be returned to jurisdiction, but surplus is used to reduce payroll rates further.
     - Increases: Lump sum payment would defray total deficit. UAAL would not be as high as would otherwise be the case.

   In any case, arbitrage risks remain the same for existing lump sum payment.

3. Structure of the financing matters
   - Inappropriate to use unrealistic assumptions about rates of return.
   - Amortization structure of bonds should match amortization of UAAL that PERS system uses.
   - Not prudent to have back weighted structured where all savings are produced in early years.

Lessons Learned

4. The "housekeeping issues" are often the most critical
   - Adequate protection and proper accounting of lump deposits are critical.
   - Statutes and regulations needed to ensure that the employers making the deposit are the ones getting the credit, and that credit is for appropriate amount.
5. Bond Related Considerations
   - Bonds are not likely to be subject to early redemption.
   - Rating agencies will scrutinize structure carefully to ensure payment of liability is not further deferred.
   - Changes "soft" liability to "hard" liability, which may put some limitations on financial flexibility.
6. Variations in payroll growth not immediately reflected in debt structure
   - Under current structure, if payroll declines, payments to PERS decline.
   - Using bonds, if payroll declines, payments on the bonds do not change.

— cost ½ %

would payroll % immediately jump to actuarial rate
yes unless go thru variable

SEATTLE-NORTHWEST SECURITIES CORPORATION

Alaska Legislative Considerations

Goal: Give all jurisdictions, at their discretion, meaningful access to capital markets for the purpose of financing pension liabilities.

1. Access
   - Express authorization for all types of jurisdictions to issue obligations for this purpose either individually or through another entity.
   - Authorization for individual jurisdictions to pool together through another entity (either state entity such as Bond Bank and/or pool created with a Trustee).
2. "Meaningful" Access
   - Without additional credit support, some jurisdictions may not be able to enter market on a subject-to-appropriation basis at a competitive rate.

- Forms of additional credit support
  - Intercept of State funding - particularly useful for school districts
  - Bond reserves
  - Bond insurance
  - Voter approval of constitutional amendment allowing use of general obligation bonds

HB 278 needs to expand to allow intercept

HB 278 – Comments

- One part of a broad solution.
- The nature of the obligation between local entities and the Bond Bank is not clear.
- Would like it expanded to cover broader intercept authority, particularly for schools. Pension obligation financing provides an opportunity to increase funds available for education.
- Would like to see additional flexibility for jurisdictions to group together through pools organized by trustee.
- Entire solution will require legislative, administrative and, potentially, constitutional changes.

Pension Bonds in Alaska: Potential Savings

Types of Obligations

- Savings would be maximized if GO bonds could be issued.
- Appropriation obligations still provide substantial savings for highly rated entities.
- Taxable.
- Non-callable.
- Opportunity to issue obligations dependent on current debt market conditions – as interest rates rise, pension obligation financing becomes less attractive.

Example: City & Borough of Juneau

Assumptions

- Investment rate of return = 8.25%
- Annual payroll growth rate = 5.50% (*)
- Past service amortization:
  - Fixed 25 years, effective June 30, 2002. (**)

*City and Borough of Juneau – Notes to audited financial statements

**State of Alaska PERS Actuarial Valuation Report as of June 30, 2002 (Page 5)

Summary of Results

- Assumes payoff of 100% 6/30/04 PERS UAAL for the City and Borough of Juneau, brought forward to March 1, 2006.

Dated Date	3/1/2006
Delivery Date	3/1/2006
Obligations Par Amount	$ 75,075,000
True Interest Cost	6.06%
Aggregate Savings	$ 23,758,921
Average Annual Savings	$ 1,079,951
Net PV Savings	$ 14,881,383
Percentage Savings of Refunding Obligations	19. 82%

SEATTLE-NORTHWEST SECURITIES CORPORATION

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Heuman –
1000 acres and development right

Rep from Municipal Bond Bank Authority
Risk & State
Legal opinion
5½ to 6½ %

Contractual obligation - left

Pension Obligation Bonds

One Employer's Perspective

Jeffrey Sinz
Chief Fiscal Officer
Municipality of Anchorage

Introduction

- Purpose of this presentation is to provide the perspective of one participating employer regarding the use of Pension Obligation Debt as a substitute for Unfunded Accrued Actuarial Liabilities
- Potential for Significant Financial Benefits appears to be widespread among participating employers
- Ultimate benefit dependant upon future earnings performance (unavoidable risk)
- Uncertainty regarding administrative issues and timing represent additional risks for employers that act early and/or alone
- Few Participating Employers have ready access to resources needed to properly Analyze the use and sale of POB's
- SOA can facilitate the use of POB's for those employers wishing to pursue and help mitigate many of the non-market based risks

Challenge/Opportunity

- Challenge
  - Large Unfunded Accrued Actuarial Liability (UAAL)
- Response (to date)
  - SB 141
  - Rapidly Increasing Employer Contribution Rates
- Opportunity
  - Substitute Pension Obligation Debt for all or portion of UAAL

PERS Challenge/Opportunity

- Statewide PERS UAAL $ 3.41 billion
- Substitute Pension Obligation Debt for UAAL
  - FV of Potential Savings $ 2.5 billion
  - PV of Potential Savings $ 1.2 billion
  - Reduction in Contribution Rate 3.85%

Source: Merrill Lynch Report dated January 2006. Assumes entire UAAL substituted with POB's, COC 5.8%, PERS earnings rate 8.25%, and Discount Rate of 5.8%

Anchorage Challenge

- Anchorage Share of PERS UAAL
  - Municipality of Anchorage (MOA) $ 288,000,000
  - Anchorage School District (ASD) $ 174,000,000
  - Total Anchorage UAAL $ 462,000,000

- Increase in Employer Contribution Rate*

	FY04	FY09
MOA	3.7%	28.7%
ASD	9.3%	28.6%

*Consolidated Normal Cost Rate Plus Past Service Rate (25 year @ 8.25%)

Anchorage Opportunity

- Substitute Pension Obligation Debt for All or Part of UAAL

SAVINGS	FV	PV
MOA	$ 134.6 mil	$ 71.4 mil
ASD	$ 78.3 mil	$ 41.8 mil
Total Anchorage	$ 212.9 mil	$ 113.2 mil

- Reduction in Contribution Rate 2.6%

Source: Seattle Northwest Securities Report, January 2006. Assumes entire UAAL substituted with POB's, COC 6.1%, PERS earnings rate 8.25%, and Discount Rate of 6.0%

Current Risks

- Financial
  - Earnings Must Exceed Cost over Life of Debt
  - Market Trends
  - Ratings Risk
- Administrative
  - Accounting
  - Investment Management
  - Cost Allocations
  - Plan Flexibility
- Legal
  - Subject to Appropriation
- Political
  - Ahead of the Curve

Summary

- Financial Impacts of Recent Changes in PERS Valuation is Real, Significant and Immediate
- Substitution of Lower Cost Pension Debt for Higher Cost UAAL Represents Significant Opportunity to Reduce Retirement Benefit Cost
- Access to Pension Debt Markets is Unclear and Risky for Individual Employers
- SOA Can and Should Facilitate Access to Pension Obligation financing alternatives and help mitigate risks
- HB278 is a Step in the Right Direction

MEMORANDUM

STATE OF ALASKA
DEPARTMENT OF REVENUE
Treasury Division

To: Representative Seaton, Chair
State Affairs Committee

Date: January 24, 2006

From: Gary M. Bader
Chief Investment Officer

Telephone: 907-465-4399

Subject: Investment of POB Proceeds

During my testimony before the House State Affairs Committee on HB 278 you asked me the likely investment asset allocation of proceeds from the sale of pension obligation bonds. Specifically you questioned the rationale of selling taxable bonds and then investing the proceeds in taxable bonds.

As you are aware, the Alaska Retirement Management Board (ARMB) is responsible for investing the assets of the retirement system. Any funds submitted to the ARMB, regardless of their source, will be invested in accordance with the ARMB's investment policy. If a large injection of cash is received by the ARMB, this may change the risk or return preferences of the Board and result in their changing the asset allocation of the funds invested in the plan. The source of the funds, whether the result of a bond issuance or from other sources, is not likely to have an impact on the asset allocation decision in and of itself. Fixed income is currently part of the asset allocation of the ARMB plan assets. The inclusion of fixed income and other investments allows the plan to minimize the risk that is needed to be taken for the return expected. In other words, if the ARMB chose not to invest in fixed income the plan would likely need to take on more risk to achieve the ARMB's expected rate of return.

Regarding the bond interest rate as a hurdle rate: since the ARMB is not issuing a bond, the interest rate on the bond would have no bearing on its asset allocation. For the issuer of the bond, however, the expected return of the plan would need to be higher than the anticipated interest rate on the bond for the issuer to benefit from issuing a bond.

cc: Gail Schubert, Chair ARMB
Tom Boutin, Revenue Deputy Commissioner

Ian Laing

From: Brad Fluetsch [bjf@gci.net]
Sent: Tuesday, January 17, 2006 8:28 AM
To: Rep. Paul Seaton
Subject: Pension Bonds
Attachments: Bradley J Fluetsch (bjf@gci.net).vcf

Lets say you issue a 20 year bond, and then lets say time goes by. In fact lets us say 15 years.

Is it prudent to have a 60/40 asset allocation when you know that money is leaving in 5 years, or 4, 3, 2, 1? What happens if 2001 is twenty years from now?

Bradley J Fluetsch, CFA
Fluetsch Financial Services, LLC

Market timing
investment $ averaging
ARM - trouble investing immediately
bond counsel, underwriters etc
Estimated cost of issuance 1-2%

Ian Laing

From: Brad Fluetsch [bjf@gci.net]
Sent: Tuesday, January 17, 2006 7:30 AM
To: Rep. Paul Seaton
Subject: Pension Bonds
Attachments: Bradley J Fluetsch (bjf@gci.net).vcf

I have been thinking about the pension bond issue and this is something I would make those professionals do for you as Chairman.

E(r) is the expected return 8.25% with an expected standard deviation of 16%. To achieve that, a 60% stock, 40% bond portfolio is used.

Add pension bonds to the equation where the proceeds are invested 100% into the stock market having no defense to your question why would I put proceeds into the bond market and guarantee a loss.

Now remodel the portfolio to earn 8.25%? You will be surprised at the answers.

Don't re-balance the portfolio and your expected return goes up to over 10% with a standard deviation ballooning well over 20%. A pension bond in the portfolio mix acts as a bond allocation reducer to the extent the cash flows and interest rates are comparable. Add a pension bond subtract Lehman Aggregate exposure. Investment the proceeds into the equity market, is going all in, in Texas Hold-em with a pair of 8's.

One other thought. I just wonder about the decision makers in Alaska. It was bad decisions by the pension board that has us in this mess and look at who made the board up? I think there is a law against giving loading pistols to children to play with.

Bradley J Fluetsch, CFA
Fluetsch Financial Services, LLC